

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

13/3

TRANSCRIPT OF RECORD

Court of Appeals of the District of Columbia

APRIL TERM, 1927.

No. 4627.

438

FREDERICK AYER, APPELLANT,

vs.

DAVID H. BLAIR, COMMISSIONER OF INTERNAL
REVENUE.

APPEAL FROM THE BOARD OF TAX APPEALS.

FILED AUGUST 12, 1927.

PRINTED SEPTEMBER 19, 1927.

Martin

M. R. Be.

Feb. 10, 1928

Court of Appeals of the District of Columbia

APRIL TERM, 1927.

No. 4627.

FREDERICK AYER, APPELLANT,

vs.

DAVID H. BLAIR, COMMISSIONER OF INTERNAL
REVENUE.

APPEAL FROM THE BOARD OF TAX APPEALS.

INDEX.

	Original	Print
Petition of appeal to Court of Appeals.....	1	1
Docket entries.....	6	4
Petition	7	5
Answer	12	9
Findings of fact and opinion.....	13	10
Order	16	13
Stipulation under Section 1002 of Revenue Act of 1926.....	17	14
Assignments of error.....	18	14
Designation of record.....	21	16
Counter designation of record.....	22	17
Excerpt from joint Exhibit A.....	23	18
Taxpayer's Exhibit No. 1.....	28	24
Statement of evidence.....	35	25
Testimony of Charles F. Damon.....	36	25
Dana H. Spiller.....	37	26
James Craig Peacock.....	38	27
Charles F. Damon.....	38	28
Stipulation	40	29

Court of Appeals of the District of Columbia

No. 4627.

FREDERICK AYER, Appellant,

vs.

DAVID H. BLAIR, Commissioner of Internal Revenue.

1 Court of Appeals of the District of Columbia,
April Term, 1927.

No. 4627.

FREDERICK AYER, Petitioner,

vs.

DAVID H. BLAIR, Commissioner of Internal Revenue,
Respondent.

*Petition for Review of Decision of United States Board
of Tax Appeals.*

To the Honorable Judges of said Court:

Now comes Frederick Ayer, the petitioner herein, by his attorneys and respectfully shows the Court:

1. Petitioner is a citizen of the United States and a resident of the State of Massachusetts.

2. On the 18th day of February, 1927, the United States Board of Tax Appeals in the proceeding before said Board entitled "Frederick Ayer, Petitioner, vs. Commissioner of Internal Revenue, Respondent, Docket No. 8184," did promulgate its decision in favor of the respondent, and as of February 23, 1927, did enter its final decision and order of redetermination that petitioner was liable for a deficiency

in income tax for the year 1920 in the amount of \$21,310.58.

3. Your petitioner, feeling himself aggrieved by the said decision and final order of redetermination entered as aforesaid, herewith petitions this Court for the review of said decision of the United States Board of Tax Appeals under the laws of the United States in such cases made and provided.

4. Pursuant to Section 1002 (*d*) of the Revenue Act of 1926 the petitioner and the Commissioner of Internal Revenue by their respective attorneys have agreed by a stipulation heretofore filed with the said Board of Tax Appeals that its decision may be reviewed by the Court of Appeals of the District of Columbia.

5. The alleged deficiency of \$21,310.58 in petitioner's income tax for 1920 is based on a proposed recomputation by the respondent of the profit or loss sustained by the petitioner on the sale in that year of 300 shares of stock of the First National Bank of Boston. The only question raised by this appeal is whether or not the United States Board of Tax Appeals erred in its final decision in which it approved the deficiency in the same amount as determined by said Commissioner.

6. A statement of the evidence adduced before said Board, in narrative form, prepared by the parties hereto and settled by a member of the said Board, duly certified by the Clerk of said Board, under its seal, is presented herewith.

7. There is presented herewith a transcript of the record of the proceedings had before the said Board, made up as near as may be in conformity with the rules of this Court governing the preparation of transcripts of record on appeal from the Supreme Court of the District of Columbia.

Wherefore, the premises considered, your petitioner prays:

1. That this application for the review of the said decision of the United States Board of Tax Appeals be granted.

2. That this Court may hear the appeal upon and for the reasons fully set forth in the assignments of error heretofore filed with said Board.

3. That this Court reverse the decision of said Board with directions to the Board to find that the petitioner suffered a loss upon the sale of said bank stock in the amount of \$35,137.50, and that the deficiency should be recomputed accordingly.

4. For such other and further relief as to the Court may seem just and proper in the premises.

Respectfully submitted,

J. C. PEACOCK,
JNO. W. TOWNSEND,
Attorneys for Petitioner.

817 Albee Building, Washington, D. C.

3 & 4 DISTRICT OF COLUMBIA, ss:

John W. Townsend, being duly sworn, deposes and says that he is one of the attorneys for the petitioner herein; that he prepared the foregoing petition; that the allegations thereof are true to the best of his knowledge, information and belief; and that this petition is not filed for any purpose of delay.

JNO. W. TOWNSEND.

Subscribed and sworn to before me this 12 day of August, 1927.

[Seal of James C. Dulin, Jr. Notary Public, District of Columbia.]

JAMES C. DULIN JR.,
Notary Public, D. C.

„ [Endorsed:] Court of Appeals of the District of Columbia, April Term, 1927. No. 4627. Frederick Ayer, Petitioner, vs. David H. Blair, Commissioner of Internal Revenue, Respondent. Petition for Review of Decision of the United States Board of Tax Appeals. James Craig Peacock, Attorney and Counselor at Law, 817 Albee Building, Washington, D. C. John W. Townsend, Attorney at Law, Washington, D. C.

Appeal of FREDERICK AYER, 141 Milk St., Boston, Mass.

Appearances: For Taxpayer, J. C. Peacock; for Commissioner, Mr. Fort, Mr. J. Gibbs.

Proceedings.

1925.

- Oct. 17. Petition received and filed.
“ 23. Copy of petition served on Solicitor.
“ 23. Notification of receipt mailed taxpayer.
Nov. 4. Answer filed by Solicitor.
“ 13. Copy of answer served on taxpayer. Assigned to General Calendar.

1926.

- Nov. 4. Hearing date set for 1-17-27.

1927.

- Jan. 17. Hearing had before Mr. Phillips on merits. Submitted—no briefs.
“ 20. Transcript of hearing 1-17-27 filed.
Feb. 18. Findings of fact and opinion rendered. Decision will be entered for Commissioner. Both sides notified.
“ 23. Order of redetermination, signed and filed. Both sides notified.
Mar. 30. Motion to fix bond filed by taxpayer.
“ 30. Order fixing bond at \$35,000.00 signed and filed. Both sides notified.
May 3. Motion to correct order of redetermination filed by taxpayer.
“ 3. Stipulation under Sec. 1002, Rev. Act. 1926 filed.
“ 3. Motion to correct order of redetermination filed by taxpayer.
“ 4. Proof of service of statement filed—settlement May 31, 1927.
“ 5. Hearing set on motion 5-24-27. Copy served on G. C.
“ 6. Copy of motion served on G. C.
“ 24. Hearing had before Mr. Phillips on taxpayer's motion to settle evidence.

- May 24. Order amending order of redetermination dated Feb. 23, 1927 and that such order be entered nunc pro tunc as of Feb. 23, 1927, signed and filed. Both sides notified.
- “ 28. Revised notice of presentation of statement of evidence filed by taxpayer.
- “ 28. Assignments of error filed by taxpayer.
- “ 28. Designation of record filed by taxpayer.
- June 8. Counter designation of record filed by G. C.
- “ 6. Hearing had before Mr. Phillips on taxpayer approval of statement of evidence for purpose of review by Ct. of Appeal, ordered Exhibit 1 and “A” be added to statement of evidence proposed by petitioner as so amended, approved.
- “ 6. Statement of evidence approved and ordered to be filed.
- 7 Filed Oct. 17, 1925. United States Board of Tax Appeals.

Copy.

United States Board of Tax Appeals.

Docket No. 8184.

Appeal of FREDERICK AYER, 141 Milk Street, Boston, Massachusetts.

Petition.

Wheaton Kittredge, 148 State Street, Boston, Mass.

James Craig Peacock, Attorney and Counsellor at Law, 817 Albee Building, Washington, D. C.

8 United States Board of Tax Appeals.

Docket No. —.

Appeal of FREDERICK AYER, 141 Milk Street, Boston, Mass.

Petition.

The above-named taxpayer hereby appeals from the determination of the Commissioner of Internal Revenue set

forth in his deficiency letter (IT: DAL1 PBM-105-60D) dated August 27, 1925, and as the basis of his appeal sets forth the following:

1. The taxpayer is an individual, whose address is 141 Milk Street, Boston, Mass.

2. The deficiency letter was mailed to the taxpayer on August 27, 1925, and was supplemented and revised by a further letter bearing the same symbols and dated October 9, 1925. (Copies of both letters are attached hereto.)

3. The taxes in controversy are income taxes for the calendar year 1920, and are more than \$10,000, to wit: \$21,310.58.

4. The determination of tax contained in the said deficiency letter is based upon the following errors:

(a) In not determining a loss on the sale on December 7, 1920, of 300 shares of stock of the First National Bank of Boston, by taking the difference between the selling price of \$85,500 and the cost of the said shares which was \$120,637.50.

5. The facts upon which the taxpayer relies as the basis of his appeal are as follows:

(a) During the years 1914 to 1917 inclusive the taxpayer purchased various blocks of stock of the First National Bank of Boston, the purchases aggregating 300 shares at a total cost of \$120,637.50. For the 300 shares so purchased by the taxpayer there were issued the following certificates of stock: #4646 for 10 shares, #4656 for 15 shares, #4771 for 10 shares, #4865 for 15 shares, 4994 for 50 shares, #5035 for 50 shares, #5216 for 50 shares, and #5529 and #5530 for 50 shares each (which two certificates were later reissued as #6616 for 10 shares).

9 (b) On December 7, 1920, the taxpayer sold the said 300 shares for \$85,500 and delivered in consummation of the sale the said certificates # #4646, 4656, 4771, 4865, 4994, 5035, 5216, and 6616.

6. The taxpayer, in support of his appeal, relies upon the following propositions of law:

(a) Under Section 202 (a) (2) of the Revenue Act of 1918 the basis for determining the gain or loss on the sale

of 300 shares on December 7, 1920, was the cost of the said 300 shares, viz. \$120,637.50.

Wherefore, the taxpayer respectfully prays that this board may hear and determine his appeal.

(Signed) WHEATON KITTREDGE,

148 State Street, Boston, Mass.,

(Signed) JAMES CRAIG PEACOCK,

817 Albee Building, Washington, D. C.,

Counsel for taxpayer.

(Please send all notices or copies thereof to Mr. Peacock.)

STATE OF MASSACHUSETTS,

County of Suffolk, ss:

Frederick Ayer, being duly sworn, says that he is the taxpayer above named; that he has read the said petition and is familiar with the statements therein contained, and that the facts therein stated are true to the best of his knowledge, information, and belief.

FREDERICK AYER.

Sworn to before me this 14th day of October, 1925.

CLIFFORD Z. CHRISTOPHER,

Notary Public.

My commission expires March 11, 1932.

10

Copy.

Treasury Department, Washington.

Office of Commissioner of Internal Revenue

Address Reply to Commissioner of Internal Revenue and refer to IT: PA-1-60D. PBM-105.

Aug. 27, 1925.

Mr. Frederick Ayer,
141 Milk Street,
Boston, Mass.

SIR:

The determination of your income tax liability for the taxable year 1920, as set forth in office letter dated March

14, 1924, disclosed an aggregate deficiency in tax amounting to \$22,372.66.

In accordance with the provisions of Section 274 of the Revenue Act of 1924, you are allowed 60 days from the date of mailing of this letter within which to file an appeal to the United States Board of Tax Appeals contesting in whole or in part the correctness of this determination.

Where a taxpayer has been given an opportunity to appeal to the United States Board of Tax Appeals and has not done so within the 60 days prescribed and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement in respect of any part of the deficiency will be entertained.

If you acquiesce in this determination and do not desire to file an appeal, you are requested to sign the enclosed agreement consenting to the assessment of the deficiency and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:PA-1-60D-PBM-105. In the event that you acquiesce in a part of the determination, the agreement should be executed with respect to the items agreed to.

Respectfully,

D. H. BLAIR

Commissioner,

(Signed)

By J. G. BRIGHT,
Deputy Commissioner.

Inclosures: Statements, Agreement—Form A.

11

Copy.

IT:PA:1. PBM-105-60D.

Oct. 9, 1925.

Mr. Frederick Ayer,
141 Milk Street,
Boston, Massachusetts.

SIR:

Reference is made to letter of September 16, 1925 from your representative, Mr. J. Craig Peacock, Albee Building, Washington, D. C., protesting against the deficiency in tax for the year 1920 as indicated by office communication of August 27, 1925.

You are advised that in accordance with Mr. Peacock's letter of September 16, 1925 a reaudit has been made of the report of the Internal Revenue Agent at Boston, Massachusetts, dated January 17, 1924, covering an examination of your books of account and records for the year 1920, and the net income shown by the previous audit has been reduced by \$581.71, representing tax paid at the source on interest from bonds bearing a tax-free covenant clause, and by \$1,460.74, representing your share of the inheritance tax paid to the State of New York by the Estate of Frederick Ayer.

Your net income adjusted in accordance with the above is \$117,079.16, on which there is a tax liability of \$31,809.45, and as \$10,498.87 has been assessed, there is a deficiency in tax of \$21,310.58 instead of \$22,372.66, as indicated by office letter of August 27, 1925.

If you do not agree to the deficiency in tax as above adjusted, you may file an appeal with the United States Board of Tax Appeals within sixty days from the original sixty-day letter of August 27, 1925.

Respectfully,

D. H. BLAIR,
Commissioner.

By ————,
Assistant to the Commissioner.

12 Filed Nov. 4, 1925. United States Board of Tax Appeals.

United States Board of Tax Appeals.

Docket No. 8184.

Appeal of FREDERICK AYER, Boston, Mass.

Answer.

The Commissioner of Internal Revenue, by his attorney, A. W. Gregg, Solicitor of Internal Revenue, for answer to the petition of this taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraphs 1, 2 and 3 of the petition.

(2) With reference to the allegations contained in paragraph 5 of the petition, admits that during the years 1914 to 1917, inclusive, the taxpayer purchased various blocks of stock of the First National Bank of Boston and sold the same during the year 1920. Specifically denies that the total cost to the taxpayer of said stock so sold in 1920 was \$120,637.50, and specifically denies that the total sales price of said stock so sold in 1920 was \$85,500.00.

(3) Specifically denies each, every and all allegations contained in taxpayer's petition not hereinabove expressly admitted to be true.

Proposition of Law.

The taxpayer's loss from the purchase and sale of stock has been correctly computed in accordance with Section 202 of the Revenue Act of 1918.

Wherefore it is prayed that the taxpayer's appeal be denied.

A. W. GREGG,
Solicitor of Internal Revenue,
Attorney for Commissioner of Internal Revenue.

Of counsel:
GEORGE G. WITTER,
Special Attorney Bureau of Internal Revenue.

13 A true copy:
Teste:
B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

United States Board of Tax Appeals.

Docket No. 8184.

FREDERICK AYER, Petitioner,
v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Promulgated February 18, 1927.

1. The original cost of stock is not necessarily the basis for determining profit or loss upon a sale.

2. Where the Commissioner determined that the original cost of stock had been reduced by the exercise of stockholder's rights to subscribe to additional stock, which rights arose out of the ownership of such original stock, *held*, that petitioner has not established the computation to be incorrect by showing only the original cost of the stock. *Miles v. Safe Deposit & Trust Co.*, 256 U. S. 247.

James Craig Peacock, Esq., for the petitioner.

A. H. Fast, Esq., and *Julian Gibbs, Esq.*, for the respondent.

The petitioner seeks a redetermination of a deficiency in income taxes for 1920 in the amount of \$22,372.66 as determined by the Commissioner. The petitioner alleges that the Commissioner committed error in failing to determine that a loss was sustained on the sale of three hundred shares of stock of the First National Bank of Boston.

Findings of Fact.

Prior to January 1, 1920, the petitioner had acquired by purchase in the open market, or by the exercise of subscription rights, three hundred shares of the capital stock of the First National Bank of Boston, at a cost to him of \$120,637.50. The ownership of these shares was evidenced by eight certificates of stock. On December 6, 1920, he sold three hundred shares of the capital stock of the First National Bank of Boston for \$85,500 and upon such sale delivered the eight certificates of stock referred to above.

Upon such sale the petitioner paid stamp taxes of \$12.

14 The Commissioner determined that in 1920 the bank offered to its stockholders one new share at \$100 for each share then held, and further determined that the petitioner exercised his right and purchased, in April, 1920, three hundred shares of the capital stock of the First National Bank of Boston for \$30,000. He determined the cost of the stock of the petitioner as follows:

Cost of original 300 shares.....	\$120,637.50
Cost of 300 additional shares.....	30,000.00
Cost of 600 shares	\$150,637.50

Upon this basis the Commissioner determined the cost to the petitioner of the three hundred shares sold to be \$75,318.75 and computed the deficiency accordingly.

Opinion.

PHILLIPS: Upon the hearing counsel for the parties submitted in evidence the Bureau letter setting out the basis for the computation of the deficiency. The petitioner proved the sales price, the numbers of the certificates delivered, and the original cost of three hundred shares evidenced by the certificates of stock which were delivered upon the sale and rested. The Commissioner then called to the stand the two witnesses who had testified on behalf of the petitioner and also counsel for the petitioner. Their testimony was to the effect that they did not know whether or not any rights to subscribe for stock had been issued in 1920 by the First National Bank of Boston to its stockholders, or whether petitioner had acquired any stock in 1920 by reason of the exercise of any such rights. Upon this record the deficiency determined by the Commissioner must be approved.

The original cost of stock is not necessarily the basis for determining profit and loss. This cost may be increased by the payment of assessments or decreased by
15 liquidating dividends, stock dividends, or the exercise of rights to subscribe to stock, which rights the Supreme Court, in *Miles v. Safe Deposit & Trust Company*, 256 U. S. 247, 42 Sup. Ct. 483, 3 Am. Fed. Tax Rep. 3168, held to be essentially analagous to a stock dividend.

There was no dispute between the Commissioner and the petitioner as to the original cost of the stock acquired before 1920 or as to the selling price of the stock sold. The sole issue was whether the original cost was decreased by the exercise of stock rights in 1920. The Commissioner having found that there was such an exercise of stock rights and the petitioner having failed to submit any evidence upon the sole question in dispute, the petitioner has failed to establish a cost basis other than that determined by the Commissioner.

Decision will be entered for the Commissioner.

16 United States Board of Tax Appeals.

Docket No. 8184.

FREDERICK AYER, Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Order.

The petitioner herein having moved that the Board enter an order *nunc pro tunc* amending its order of redetermination so as to determine the deficiency in the amount of \$21,310.58 instead of \$22,372.66, said motion having duly come on for hearing, and the parties having appeared by counsel and consented to the granting of said motion, it is

Ordered that the order of redetermination herein dated February 23, 1927, be and the same is hereby amended to read as follows:

“Order of Redetermination.

“Pursuant to the Board’s findings of fact and opinion, promulgated February 18, 1927, it is

“Ordered and decided that, upon redetermination, the deficiency for the year 1920 is \$21,310.58.

(Signed)

PERCY W. PHILLIPS,

Member U. S. Board of Tax Appeals.

Dated Washington, D. C., February 23, 1927.”

and it is

Further ordered that such order of redetermination as amended be entered, *nunc pro tunc* as of February 23, 1927.

Dated Washington, D. C., May 24, 1927.

_____,
Member United States Board of Tax Appeals.

14 FREDK. AYER VS. D. H. BLAIR, COM. OF INT. REV.

17 Filed May 3, 1927. United States Board of Tax Appeals.

United States Board of Tax Appeals.

Docket No. 8184.

FREDERICK AYER, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Stipulation under Section 1002 of Revenue Act of 1926.

The petitioner and the respondent by their respective attorneys of record hereby stipulate and agree that in accordance with Section 1002 (*d*) of the Revenue Act of 1926 a final decision of the Board of Tax Appeals in the above entitled proceeding may be reviewed by the Court of Appeals of the District of Columbia.

J. C. PEACOCK,
Attorney for Petitioner.

A. W. GREGG,
General Counsel Bureau of Internal Revenue.

18 Filed May 28, 1927. United States Board of Tax Appeals.

United States Board of Tax Appeals.

Docket No. 8184.

FREDERICK AYER, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Assignments of Error.

Now comes the petitioner by his attorney, J. C. Peacock and assigns as error that:

1. The Board erred in that its decision is unsupported by the evidence or by the findings of fact.

2. The Board erred in that its decision is contrary to that which is required by the evidence and by the findings of fact.

3. The Board erred in holding that upon the record before it the deficiency of \$21,310.58 as determined by the Commissioner must be approved and in redetermining it in that amount.

4. The Board erred in ignoring the pleadings in the case and in holding that the original cost and the selling price of the stock was not in issue whereas in the pleadings issue was joined as to both.

5. The Board erred in ignoring the pleadings in the case and in holding that "The sole issue was whether the original cost was decreased by the exercise of stock rights in 1920" whereas in the pleadings no reference whatever was made as to any stock rights, nor was issue joined thereon.

6. The Board erred in holding that petitioner had
19 "failed to submit any evidence upon the sole question in dispute," referring to said alleged exercise of stock rights as to which no reference was made nor issue raised in the pleadings.

7. The Board erred in holding that petitioner, because of his not having submitted any evidence on said alleged exercise of stock rights, had failed to establish a cost basis other than that determined by the Commissioner.

8. The Board erred in approving a tax determination based on an alleged exercise of stock rights the actual occurrence of which the Board failed to find as a fact and as to which there was no evidence in the record nor reference in the pleadings.

9. The Board erred in holding that the burden of proof was or could have been on petitioner to prove that there had been no "liquidating dividends, stock dividends, or the exercise of rights to subscribe to stock" and in not holding that such facts, if a defense at all, are an affirmative defense and must be pleaded and proved by the Commissioner.

10. The Board erred in so holding for the further reason that no issue as to liquidating dividends, stock dividends, or the exercise of rights had been raised in the pleadings.

11. The Board erred in holding that a purchase of 300 additional shares for \$30,000 through the exercise of stock rights, even if proven or assumed as a fact, would for income tax purposes have any effect whatever on the basis or cost of the 300 original shares which were sold by petitioner in 1920.

12. The Board erred in not holding that petitioner's loss on the sale in 1920 of 300 shares of said stock should be computed as the difference between the original cost of \$120,637.50 and the selling price of \$85,500 (or of \$85,500 less \$12 stamp tax), and that the deficiency determined by the Commissioner should be redetermined accordingly.

J. C. PEACOCK,
Attorney for Petitioner.

21 Filed May 28, 1927. United States Board of Tax Appeals.

United States Board of Tax Appeals.

Docket No. 8184.

FREDERICK AYER, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Designation of Record.

In preparing the record for court review in the above entitled case the clerk will please include:

Petition to the Board.

Answer of the Commissioner.

A memorandum that no other pleadings were filed by either party.

Findings of fact.

Opinion.

Final order of redetermination dated February 23, 1927, as amended *nunc pro tunc* May 24, 1927.

Statement of the Evidence.

Stipulation under Section 1002 of Revenue Act of 1926

Assignments of Error.
Designation of Record.

J. C. PEACOCK,
Attorney for Petitioner.

22 Filed Jun. 8, 1927. United States Board of Tax Appeals.

United States Board of Tax Appeals.

Docket No. 8184.

FREDERICK AYER, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Counter Designation of Record.

In addition to the items contained in the designation of record filed in the above-entitled appeal on behalf of the taxpayer, it is requested on behalf of the Commissioner that the following documents be included in the record of this appeal for purposes of review in the courts:

Revenue Agent's Report dated December 22, 1923, submitted in evidence in this appeal and marked Joint Exhibit A. (Pages numbered 1 to 4, both inclusive, and page numbered 5 to "Schedule No. 3" of Joint Exhibit A may be omitted from the record.)

Letter dated March 14, 1924 addressed to Frederick Ayer, this taxpayer, introduced in evidence in this appeal and marked Taxpayer's Exhibit No. 1.

(Signed.)

A. W. GREGG,
General Counsel Bureau of Internal Revenue.

Of Counsel:

A. H. FAST,
Special Attorney Bureau of Internal Revenue.

Schedule No. 3

Block Adjustments—Year 1920.

Block	Return	Additions	Reductions	Corrected
B	9,145.00	.....	.....	9,145.00
C .....	.....	2,659.20	.....	2,659.20
D (Loss)	82,141.87	.....	45,902.47 (Loss)	36,239.40
F	6,252.53	22,832.87	.....	29,085.40
G	5,196.45	.....	.....	5,196.45
H	168,998.17	.....	20,716.87	148,281.30
I	619.98	.....	.....	619.98
J	108,070.26	50,677.67	.....	158,747.93
K	35,404.73	.....	119.94	35,284.79
L	72,665.53	50,797.61	.....	123,463.14
M	4,441.53	.....	100.00	4,341.53
N Total	68,224.00	50,897.61	.....	119,121.61

Schedule No. 3-A.

Explanation of Items—Year 1920.

B. Salaries, etc.:	
Estate of Frederick Ayer (Sr.)	2,700.00
Trust under indenture of Frederick Ayer (Sr.) dated 2-24-11	5,000.00
Ledyard Realty Trust (All of the 141 Milk Street, Boston)	750.00
Miscellaneous fees	695.00
	9,145.00
C. Other income, thru Trust under indenture of Frederick Ayer (Sr.) dated 2-24-11, is set up at	2,659.20
to agree with separate report on this Trust.	
Loss on sales of securities reduced 45,902,47, as follows:	
	Increases in income.
On sale of 50M Fourth Liberty Loan, average cost used on return	47,389.00
Substituting cost of earliest purchases	46,973.08
	415.92

		Increases in income.
On sale of 3M Woodward Iron Co. 5's, average cost used on return	2,359.38	
Substituting cost of earliest purchases	2,253.75	
		105.63
On sale of 300 First National Bank stock cost was shown as	120,637.50	
Cost corrected, as shown in Exhibit A	75,318.75	
		45,318.75
Profit on sale of Burrage note, omitted on tax return, cost..	5,980.00	
Sale price	6,580.00	
		600.00
Total increases		46,440.30

24

		Decreases.
On sale 100 American Tele- phone, average cost used on return	11,883.67	
Substituting cost of earliest purchases	11,900.00	
		16.33
On sale 150 Crucible Steel, cost was under- stated on tax return, thru clerical error.		300.00
On sale of Gillette Safety Razor Co. rights, entire proceeds was shown as profit.....	312.32	
Profit as corrected, see Ex- hibit B.....	90.82	
		221.50
Total decreases		537.83
Net increases in income, Block D...		45,902.47

F. Interest on tax free covenant bonds, directly:

Columbia Gas & Electric Co. 5's	100 00
Lincoln Pulpwood Co. 6's	600.00
U. S. Smelting, Refining & Mining Co. 6's	3,990 00
Woodward Iron Co. 5's	1,575 00
Ventura Oil Co. 7's	525.00
	6,790.00
Less: net accrued paid	537.47
Total directly	6,252 53
Add Amount of tax free bond int. Thru Trust u/i of Frederick Ayer dated 2-24-11, not shown on return..	22,832 87
	29,085.40

Increase to agree with separate report
on the Trust mentioned.

G. Interest on bonds, not tax free	2,881 25
Foreign dividend	400 00
Miscellaneous interest	1,790 15
2% of 6,252.53 shown in Block F	125 05
	5,196 45

The 2% of Trust tax free bond interest
in Block F was added on the Fiduciary
return Form 1041, and therefore reflects in
Block C above.

H. Dividends	3,479.07	Return	Corrected
Directly (including bank stock taxes		92,432.32	92,457.32
Thru Trust u/i of Frederick Ayer		76,565.85	55,823.98
		168,998.17	148,281.30

Directly increased \$25.00, clerical omission.

Trust item decreased to agree with separate report.

I. Taxable interest on U. S. obligations, correct	619.98
	21,420.53

25

K. Interest paid	21,420.53	
Mass. income tax, personal...	1,133.32	
Proportion Mass. income tax, Trust u/i of Frederick Ayer	6,757.73	
Bank stock taxes paid by banks	3,479.07	
Town of Wenham taxes.....	1,526.44	
Luxury taxes and War taxes on Club Dues	119.94	
Internal Revenue Stamps...	115.16	
		13,131.66
Expenses		732.60
Total, corrected		35,284.79

Proportion of Mass. income tax, Trust u/i of Frederick Ayer, is an offset to the income from this trust, as previously explained in Schedule No. 1-A. The reduction in this Block is due to the fact that on return Luxury and Club Dues Taxes, \$119.94 was claimed twice, thru clerical error.

Expenses, 732.60 comprises clerk hire, office rent, and other incidental office expenses.

M. Contributions:

Associated Charities of Boston.....	10 00
Smith College Fund.....	100 00
Mass. Police Assoc'n, Inc.....	15 00
Denison House	25 00
Beverly Hospital	2,500 00
European Children's Fund.....	100 00

Harvard Endowment Fund.....	591 53
Hill School Foundation Fund.....	1,000 00
Total Allowed	4,341 53
Mass. Credit Union Association...	100 00
Total Claimed	4,441 53

26

*Schedule No. 4.**Computation of Tax—Year 1920.*

Total Net Income, From Schedule No. 3.....	119,121.61
Less: Exemption	2,600 00
Dividends	148,281.30
Interest on U. S. Obligations	619.98
	151,501.28
Income subject to normal tax.....	None.
Surtax on 119,121.61.....	33,453.24
Less: 2% paid at source.....	581.71
Balance of tax due.....	32,871.53
Previously Assessed	10,498.87
Additional Tax to be as- sessed	22,372.66

27

EXHIBIT A.

Reduction of Cost of 300 First National Bank Stock.

(See Schedule No. 3-A, page 6.)

In 1914, 1915 and 1916, taxpayer purchased 100 shares First National Bank stock, at cost of	43,787.50
In 1917 bank offered one new share at \$300 for each 2 held. Taxpayer exercised his rights and purchased 50 shares at a cost of.....	15,000.00
Also purchased in the open market sufficient rights to purchase 150 shares, cost of rights....	16,850.00
150 shares, at subscription price	45,000.00
	61,850.00

Therefore, on January 1, 1920, he owned 300 shares, costing	120,637.50
In 1920 bank offered 1 new share at \$100 for each 1 old. Taxpayer exercised his rights, and purchased 300, in April.....	30,000.00
Cost of 600 shares.....	<u>150,637.50</u>

In December he sold 300 shares, and used on tax return the cost above shown of 120,637.50, leaving the remaining 300 shares on his books at	30,000.00
The cost of the 300 shares sold is corrected to being $\frac{1}{2}$ of the 150,637.50, leaving the 300 shares remaining at the same cost of 75,318.75.	75,318.75

(See T. D. 3402.)

EXHIBIT B.

Sale of Gillette Safety Razor Co. Rights.

(See Schedule No. 3-A, Page 6.)

In 1919 taxpayer purchased 50 Gillette at cost of 7,437.50
In 1920 received rights to subscribe at \$100 (1 for each 10).

Sold rights for \$312.32.

Subscription price 5 shares.....	500.00
55 shares.....	7,937.50
1 share	144.30
5 shares, cost.....	721.50
Sale price of rights.....	312.32
Subscription price 5 shares, 500.00 sale price....	812.32
Taxable profit	90.82

Copy.

28-34

TAXPAYER'S EXHIBIT No. 1.

Filed March 14, 1924.

Treasury Department, Washington.

IT:PA:1. MA-101-App.

Mar. 14, 1924.

Mr. Frederick Ayer,
South Hamilton, Mass.

SIR:

An examination of your income tax returns and of your books of account and records for the years 1919 and 1920 disclosed an additional tax liability for these years amounting to \$24,763.77, as shown in detail in the attached statement.

In accordance with the provisions of Section 250 (*d*) of the Revenue Act of 1921, you are granted thirty days within which to file an appeal and to show cause or reason why this tax or deficiency should not be paid. The appeal, if filed, must be addressed to the Commissioner of Internal Revenue, Washington, D. C., for the specific attention of IT:PA-1; MA-101-App.

Treasury Decision No. 3492, setting forth the privileges of Taxpayers in cases of appeal, is attached for your information and guidance.

Where a taxpayer has been given an opportunity to appeal and has not done so, as set forth above, and an assessment has been made, or where a taxpayer has appealed and an assessment in accordance with the final decision on such appeal has been made, no claim in abatement of the assessment will be entertained.

This assessment is in addition to all other outstanding and unpaid assessments appearing upon the Collector's lists.

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

Respectfully,
(Sgd.)

J. G. BRIGHT,
Deputy Commissioner.

Inclosure: T. D. 3492.
Copy.

33 *Statement.*

IT: PA-1.
MA-101-App.

In re Mr. Frederick Ayer, South Hamilton, Mass.

Additional Tax.

1919	\$2,391 .11
1920	22,372 .66
	\$24,763 .77

The audit as made by the examining officer has been reviewed and approved by this office.

Copy.

34 United States Board of Tax Appeals.

UNITED STATES OF AMERICA,
District of Columbia, ss:

I, B. D. Gamble, Clerk of the United States Board of Tax Appeals, hereby certify the foregoing pages numbered 1 to 30 both inclusive, to be a true and correct transcript of the record, according to directions of counsel herein filed, copy of which is made part of this transcript, in cause No. 8184 wherein Frederick Ayer is petitioner and David H. Blair, Commissioner of Internal Revenue, is the respondent as the same remains upon the files and of record in said Board.

In testimony Whereof, I hereunto subscribe my name and affix the seal of said Board, at the City of Washington, in said District this 24th day of June, 1927.

[Seal U. S. Board of Tax Appeals, 1924.]

B. G. GAMBLE,
Clerk.

35 Filed Jun. 6, 1927. United States Board of Tax Appeals.

United States Board of Tax Appeals.

Docket No. 8184.

FREDERICK AYER, Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Statement of Evidence.

The above entitled case came on for hearing before the Board of Tax Appeals (Mr. P. W. Phillips sitting as a division of the Board for that purpose) on January 17, 1927, whereupon the following occurred:

The Revenue Agent's Report of December 22, 1923, which is the only communication which shows the details of the computation of the deficiency at \$22,372.66, (and which was incorporated by reference in the Commissioner's 30 day audit letter of March 14, 1924, which letter was in turn incorporated by reference in the deficiency letter of August 27, 1926) was received in evidence as "Joint Exhibit A" solely for the purpose of showing how the Commissioner computed the deficiency and for that purpose alone.

36 The 30 day letter of March 14, 1924, referred to above, and which adopted the deficiency as computed by the revenue agent and merely stated that his audit had been reviewed and approved was received as "Petitioner's Exhibit No. 1"

Charles F. Damon, called as a witness for petitioner, having been first duly sworn, testified in substance as follows:

He has been stock clerk and cashier with Wrenn Brothers & Co. of Boston for about 10 years, and was stock clerk in 1920.

He identified receipt dated December 6, 1920, given by Wrenn Bros. & Co. to petitioner for 300 shares of stock of

First National Bank of Boston represented by following certificates: No. 4865 for 15 shares; No. 4771 for 10 shares; No. 5035 for 50 shares; 5216 for 50 shares; No. 4994 for 50 shares; No. 4656 for 15 shares; No. 6616 for 100 shares; and No. 4646 for 10 shares, which receipt was received in evidence as "Petitioner's Exhibit No. 2."

He identified Wrenn Bros. & Company's "in and out sheet" showing the receipt of 300 shares of said stock from petitioner and giving the same certificate numbers, and number of shares represented by each, which sheet was received in evidence as "Petitioner's Exhibit No. 3."

He identified a sheet from Wrenn Bros. & Company's "stock register of the First National Bank stock" showing that on December 6, 1920 they received 300 shares of said stock and that on December 7, 1920, the account was squared, which sheet was received in evidence as "Petitioner's Exhibit No. 4."

He identified a sheet from Wrenn Bros. & Company's bookkeeping ledger of petitioner's account showing December 6, 1920, 300 shares of First National Bank stock received, and December 7, 1920, 300 shares of same sold at \$285 per share, \$85,500, which sheet was received in evidence as "Petitioner's Exhibit No. 5."

37 The witness was not cross-examined.

Dana H. Spiller, called as a witness for petitioner, having been first duly sworn, testified in substance as follows:

He is a bookkeeper, and during the years 1915 to 1920 inclusive was employed as such in office of Frederick Ayer, Sr., in keeping his books and those of two of his sons, one of whom is the petitioner.

The records of the purchase of the 300 shares which it had been testified had been sold were kept in petitioner's cash book and journal.

He identified petitioner's cash book covering the period October 11, 1912, to December 31, 1919, and petitioner's journal covering the same period, which were received in evidence as "Petitioner's Exhibits Nos. 6 and 7" respectively.

He then identified from these exhibits the original entries of the purchase of the said 300 shares. Said entries showed that said shares represented by the certificate numbers

listed in Petitioner's Exhibits Nos. 2 and 3 had been purchased in various lots over a period beginning in January, 1915, and ending in March, 1917, and at a total cost of \$120,637.50.

The witness was not cross-examined, whereupon petitioner rested.

Dana H. Spiller was then called as a witness for respondent, and having been first duly sworn testified in substance as follows:

During 1920 the books of petitioner were not kept personally by the witness, but by a young man under his supervision. During 1915 to 1917, inclusive, he had personally kept petitioner's books. He knew that petitioner owned the 300 shares already testified to but did not know whether any rights with respect thereto had been offered to petitioner in 1920 or whether petitioner in 1920 purchased or owned any other shares of said stock, and had no recollection of knowing of any entries relating thereto.

38 On cross-examination by counsel for petitioner he testified that in the course of each of the years from 1915 to 1920 he kept many different accounts and made hundreds of entries.

On redirect examination he further testified that during the years in question he kept a number of different sets of books, that his duties were solely those of a bookkeeper, that he had no recollection as to any rights offered by the First National Bank of Boston in 1920, or of petitioner having ever conversed with him about it.

James Craig Peacock, petitioner's counsel, having first been duly sworn was called as a witness for respondent and testified in substance as follows:

He had no knowledge at all that petitioner as a stockholder in First National Bank of Boston had any rights offered to him in April 1920 except that he had seen the revenue agent's report (Joint Exhibit A). He had never met petitioner. He had had the agent's report for several years and it probably had been sent or given to him by petitioner's Boston attorney. He had not conversed or corresponded with the latter about the facts as to any such rights

because they had taken the position that such facts were not relevant and that the only relevant facts were those relating to the cost of the stock which was sold. He did not know that there had ever been any dispute about the cost of the original 300 shares of stock. It was his opinion that the case should be considered solely under Section 202 (a) of the Revenue Act of 1918.

Charles F. Damon was then called as a witness for respondent, and having been first duly sworn testified in substance that he never had had any business conversations with petitioner relative to any dealings in stocks and bonds.

39 Whereupon respondent rested and after argument by counsel the case was submitted.

The foregoing is the substance of all the testimony and evidence adduced before the Board at the hearing of this case, and together with the pleadings and the record in this case is all that was considered by the Board as a basis for its final order and decision entered herein.

Exhibit 1 and Exhibit A (or so much thereof as respondent may not waive) to be incorporated herein as a part of the statement of income. P. W. P.

Whereupon, for the purpose of hearing the said case upon appeal, the foregoing statement of evidence is according-approved and signed by the Board, now for then, this 6th day of June, 1927.

By the Board:

(Signed) **PERCY W. PHILLIPS.**
PERCY W. PHILLIPS,
Member United States Board of Tax Appeals.

June 6, 1927.

The foregoing certified to be a duplicate original Statement of Evidence as filed of record June 6, 1927.

[Seal Board of U. S. Tax Appeals, 1924.]

D. B. GAMBLE,
Clerk U. S. Board of Tax Appeals.

40 Court of Appeals of the District of Columbia, April
Term, 1927.

No. 4627.

FREDERICK AYER, Petitioner,

vs.

DAVID H. BLAIR, Commissioner of Internal Revenue,
Respondent.

Stipulation as to Omission in Printing Record.

Now come the petitioner and the respondent herein by their respective attorneys and hereby stipulate and agree that in the printing of the transcript of record heretofore filed in this proceeding there may be omitted as immaterial to the issues of the case pages of the original transcript, as certified by the Clerk to the Board of Tax Appeals, numbered 25 to 28, both inclusive.

J. C. PEACOCK,

W. S.,

JNO. W. TOWNSEND,

Attorneys for Petitioner,

817 Albee Building, Washington, D. C.

A. W. GREGG,

General Counsel Bureau of Internal Revenue.

41 [Endorsed:] Court of Appeals of the District of
Columbia, April Term, 1927. No. 4627. Frederick
Ayer, Petitioner, vs. David H. Blair, Commissioner of In-
ternal Revenue, Respondent. Stipulation as to omission in
printing record. James Craig Peacock, Attorney and Coun-
selor at Law, 817 Albee Building, Washington, D. C. John
W. Townsend, Attorney at Law, Washington, D. C. Court
of Appeals, District of Columbia. Filed Sep. 7, 1927.
Henry W. Hodges, clerk.

Endorsed on cover: Board of Tax Appeals. No. 4627.
Frederick Ayer, appellant, vs. David H. Blair, Commis-
sioner of Internal Revenue. Court of Appeals, District of
Columbia. Filed Aug. 12, 1927. Henry W. Hodges, clerk.

COURT OF APPEALS
DISTRICT OF COLUMBIA
FILED

631 18 13.7

IN THE

Thurs. 18. 1927
Court of Appeals, District of Columbia

APRIL TERM, 1927.

—
No. 4627.
—

FREDERICK AYER, *Appellant,*

vs.

DAVID H. BLAIR, COMMISSIONER OF INTERNAL REVENUE,
Appellee.

—
BRIEF FOR APPELLANT.
—

JAMES CRAIG PEACOCK,
JOHN W. TOWNSEND,
Attorneys for Petitioner.

WHEATON KITTREDGE,
Of Counsel.

INDEX.

	Page
Statement of the Case	1
Opinion of the Board	5
Questions Involved	5
Argument	6
I. The original cost and the selling price of the stock sold was in issue; the question whether it was decreased by the exercise of stock rights was not in issue; and the appellant fully satisfied his burden of proof and established his case	6
II. Even if a question of exercise of stock rights had been in issue, it would have been as an affirmative defense, the burden of pleading and proving which would have been on the Commissioner	13
III. Even if an exercise of stock rights had been put in issue and proven, the original cost as a basis for determining gain or loss would not have been affected or decreased thereby	24
IV. The Commissioner has himself in a recent regulation repudiated the method which was used in the Miles case and which he applied in the present case	31
V. The decision of the Board should be reversed and final judgment entered for the appellant	35

CASES CITED.

Acorn Refining Co., Appeal of, 2 B. T. A. 250, 254 ..	35
Buffalo Wills-Sainte Claire Corp., Appeal of, 2 B. T. A. 364, 365	12
Clarke, Appeal of Harold B., 2 B. T. A. 555-557 ..	18
Crosswell v. Commissioner, 6 B. T. A. 1315, 1320..	12
Chicago Railway Equipment Co. v. Blair, C. C. H. Tax Service, Par. 7225	24

	Page
General Lead Batteries Co., 2 B. T. A. 392, 395....	17
Goldsmith v. Board of Tax Appeals, 55 App. D. C.	
229	7
Gould v. Gould, 245 U. S. 151, 153	30, 31
Hunter Coal Co., 2 B. T. A. 828.....	16
Lyon, Appeal of J. M., 1 B. T. A. 378, 379.....	16
Miles v. Deposit & Trust Co., 256 U. S. 347.27, 30, 31, 32	
Smietanka v. First Trust & Savings Bank, 257	
U. S. 602, 606.....	30, 31
United States v. Merriam, 263 U. S. 179.....	27
Weaver, Appeal of W. L., 2 B. T. A. 709, 711....	12

STATUTES CITED.

Revenue Act of 1918:	
Sec. 202(a), (40 Stat. 1060)	6, 15, 23, 33
Revenue Act of 1924:	
Sec. 900 (h), (43 Stat. 337)	7
Revenue Act of 1926:	
Sec. 907 (a), (44 Stat. 107)	7
Secs. 1001-1002	1
Sec. 1003	35
Sec. 204	32, 33
Sec. 1108	33

OTHER AUTHORITIES.

Departmental Regulations:	
Regulations 69, Art. 1545	19
Regulations 69, Art. 39	32
Regulations 45, Art. 838	21
Regulations 45, Art. 857	21, 22
Departmental Rulings:	
G. C. M. 1552, IV-19-3220	20
Opinion 942, Cum. Bul. 1919, p. 300	20
A. R. R. 8226, Cum. Bul. III-2, p. 116.....	32
T. D. 4018	33
31 Cyc. 671	24
31 Cyc. 109	23
Jones on Evidence, Sec. 179	14

IN THE
Court of Appeals, District of Columbia

APRIL TERM, 1927.

No. 4627.

FREDERICK AYER, *Appellant*,

vs.

DAVID H. BLAIR, COMMISSIONER OF INTERNAL REVENUE,
Appellee.

BRIEF FOR APPELLANT.

STATEMENT OF THE CASE.

This is an appeal from a decision of the United States Board of Tax Appeals as provided in sections 1001-1003 of the Revenue Act of 1926 (44 Stat. 109). It was filed in this Court in accordance with a stipulation (R. 14) made under the authority of Section 1002 of that act. The Board's determination was originally entered on February 23, 1927 (R. 13), and was

amended *nunc pro tunc* on May 24, 1927 (R. 13). The present appeal was filed August 12, 1927, which is within the statutory six months after the earliest of said dates. A statement of the evidence in the form prescribed by the rules of court will be found at R. 25-28. No error is assigned as to the admission or rejection of evidence, the assignments of error (R. 14) relating entirely to the final decision of the Board.

In his appeal to the Board the appellant, Frederick Ayer, the petitioner below, sought a redetermination of a deficiency in income taxes for 1920 in the amount of \$21,310.58 as determined by the appellee, the Commissioner of Internal Revenue. The Board redetermined the deficiency in the same amount, its findings of fact and opinion being officially reported at 6 B. T. A. 152 and also printed at R. 10-12.

The several questions now presented to this Court all arise out of or relate to the basis to be used in determining the gain or loss on the sale by the appellant in 1920 of 300 shares of stock of the First National Bank of Boston.

In his petition to the Board (R. 5) the appellant pleaded that the said 300 shares were acquired by him during the years 1914 to 1917 inclusive at a cost of \$120,637.50, and that on December 7, 1920, he sold the same shares (specifically identified by certificate numbers) for \$85,500. He submitted that the basis for determining the gain or loss on said sale was the said cost of \$120,637.50, and that the Commissioner erred in not determining a loss on said sale by taking the difference between the selling price of \$85,500 and the cost of \$120,637.50 (on which basis the appellant had made his income tax return).

In his answer (R. 9) to said petition the appellee Commissioner of Internal Revenue (hereinafter referred to as the Commissioner) admitted that during the years 1914 to 1917, inclusive, the taxpayer purchased various blocks of said stock and sold the same in 1920, but specifically denied that the total cost of said stock to the taxpayer was \$120,637.50, and that the total sales price of said stock was \$85,500, *and pleaded no other or additional facts*, whereupon the case was at issue before the Board and came to trial.

At the trial before the Board counsel for the appellant and the Commissioner, in order to show how the Commissioner had computed the proposed deficiency and for that purpose alone, jointly introduced in evidence a revenue agent's report (Joint Exhibit "A," R. 18-23) which contains the only computation of the proposed deficiency and which was adopted by the Commissioner and incorporated by reference in his deficiency letter (R. 7). In so doing the Commissioner assumed and determined that in 1920 the appellant had exercised rights offered by the bank to purchase one new share at \$100 for each share he then held, that he had thus purchased 300 additional shares for \$30,000, and that the total cost or basis to the appellant of the 300 shares sold was therefore only \$75,318.75, *i. e.*, one-half of the sum of the cost of the original 300 shares (\$120,637.50) and the cost of the second 300 shares (\$30,000). He thus reduced the basis and increased the appellant's taxable income by ~~\$75~~ \$75,318.75. This agent's report was received in evidence subject to the express limitation that it was "solely for the purpose of showing how the Commissioner computed the deficiency and for that purpose alone" (R. 25) and *it was not evidence of the truth of any of the facts therein alleged.*

The appellant then proved the facts put in issue by the pleadings, viz.—that the cost in 1914 to 1917 of the 300 shares represented by certain specified stock certificates was \$120,637.50 (R. 26-27), and that he sold for \$85,500 the 300 shares represented by those same certificates which he delivered in consummation of the sale (R. 25-26), and rested (R. 27). Those were the facts specifically denied in the Commissioner's answer and were the only facts put in issue by the pleadings.

The Commissioner called several witnesses to the stand but failed to offer evidence of or to prove any relevant facts, and there was no proof whatever as to any facts relative to the alleged rights or exercise of rights to purchase any additional 300 shares or that appellant had ever purchased any additional shares for \$30,000 or any other price (R. 27-28).

The Board's findings of fact (R. 11) were substantially the same as the evidence, viz.—that the appellant bought the stock after 1913 and at a cost of \$120,637.50 and sold for \$85,500 the stock represented by the same certificates; and that the Commissioner computed the deficiency on the basis referred to above. The Board made no finding, however, that any such rights had in fact either been issued to or exercised by the appellant, or that he had in fact ever owned any shares of stock of the First National Bank of Boston other than the 300 shares as to which it found the cost and selling price.

On this record the Board held that the deficiency determined by the Commissioner must be approved for reasons which it states in its opinion. (R. 12).

OPINION OF THE BOARD.

The opinion of the Board (R. 12) was in effect that the determination of the Commissioner must be approved because—

1. The original cost and the selling price of the stock sold was not in issue, and “the sole issue was whether the original cost was decreased by the exercise of stock rights in 1920.”

2. The burden of proof or of going forward was on the petitioning taxpayer to show affirmatively that the cost was not decreased by an exercise of stock rights in 1920.

3. The cost of stock must, for purposes of the basis for determining profit or loss, be decreased by the exercise of rights to subscribe to additional stock.

QUESTIONS INVOLVED.

The appellant believes that the Board erred in each of the above three rulings, and accordingly submits to this Court the following principal questions:

1. *Was the exercise of stock rights or its effect in issue at all, and on the contrary were not the only points in issue the cost and the selling price of the original stocks, both of which were fully proved by appellant?*

2. *Was not the burden of proof or of going forward with respect to the alleged exercise of stock rights (if relevant at all) on the Commissioner rather than on the appellant, and did not the Board err in holding that the appellant had failed to establish his case?*

3. *Does the original cost of stock as a basis for determining gain or loss have to be decreased in case of an exercise of stock rights, and if so by*

what amount—or, in other words, was evidence as to any stock rights or exercise thereof relevant in any view of the case?

The appellant submits that he has satisfied any burden of proof or of going forward that was on him; that no question as to whether there had been any exercise of stock rights was in issue, and that even if it had been in issue the burden of pleading and proving it would have been on the Commissioner; that no such question as to any exercise of stock rights was relevant as a matter of law because the original cost of the stock sold would not have had to be reduced even if an exercise of stock rights had been established; and that if this Court finds with him on any one of these points then the decision of the Board should be reversed and judgment entered for the appellant.

ARGUMENT.

I. The original cost and the selling price of the stock sold was in issue; the question whether it was decreased by the exercise of stock rights was not in issue; and the appellant fully satisfied his burden of proof and established his case.

The appellant in 1920 sold 300 shares of First National Bank stock for \$85,500 (R. 25-26). The Revenue Act of 1918 (40 Stat. 1057) was in effect for that year and governed the determination of the profit or loss on the sale. Section 202 (a) of that Act provided:

“Sec. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; * * *

The appellant having acquired all 300 shares since 1913 and at a cost aggregating \$120,637.50 (R. 26-27) accordingly deducted in his income tax return a loss in the amount of the difference between \$120,637.50 and the basic cost of \$85,500 as provided by the statute.

In due course the appellant's return was examined by a revenue agent who made a report in which he claimed that in 1920 the appellant had in connection with said stock received and exercised rights to purchase an additional 300 shares for \$30,000; that the cost of these additional shares should be averaged in with the cost of the shares actually sold, and the basic cost of the latter for income tax purposes thus reduced to \$75,318.75; and that the appellant's taxable income should be increased by the amount of the reduction.

The Commissioner in making his final audit of appellant's return approved the revenue agent's report and incorporated it by reference in his final deficiency letter in which he determined a tax deficiency in the amount of \$21,310.58 (R. 7-8). From that determination the appellant had a right to appeal by filing a petition with the Board of Tax Appeals (Revenue Act of 1924, Secs. 274, 280; 43 Stat. 298, 301).

On October 17, 1925, the appellant duly filed his petition with the Board (R. 5-7). The rules of the Board*

*NOTE.—The authority to make such rules is expressly conferred on the Board by the Revenue Act of 1924, Sec. 900 (h) (43 Stat. 337), and by the Revenue Act of 1926, Sec. 907 (a) (44 Stat. 107), and the validity of rules so made has already been upheld by this Court, *Goldsmith v. Board of Tax Appeals*, 55 App. D. C. 229; 4 Fed. (2d) 422.

provided then, as they still do (Rule 5) that the petition should contain:

“(d) Clear and concise assignments of error alleged by the taxpayer to have been committed by the Commissioner of Internal Revenue in determining the tax liability of the petitioner; such assignments of error shall be numbered.

(e) A clear and concise statement of the facts upon which taxpayer relies as constituting the basis of his appeal.”

The appellant, believing that both in law and in fact the original cost and the selling price were the only factors which should enter into the computation of the gain or loss on this sale, assigned as error in paragraph 4 (a) of his petition the Commissioner's failure to determine a loss by taking the difference between those two figures (R. 6), and pleaded only the following facts (R. 6):

“5. The facts upon which the taxpayer relies as the basis of his appeal are as follows:

(a) During the years 1914 to 1917 inclusive the taxpayer purchased various blocks of stock of the First National Bank of Boston, the purchases aggregating 300 shares at a total cost of \$120,637.50. For the 300 shares so purchased by the taxpayer there were issued the following certificates of stock; #4646 for 10 shares, #4656 for 15 shares, #4771 for 10 shares, #4865 for 15 shares, #4994 for 50 shares, #5035 for 50 shares, #5216 for 50 shares, and #5529 and #5530 for 50 shares each (which two certificates were later reissued as #6616 for 100 shares).

(b) On December 7, 1920, the taxpayer sold the said 300 shares for \$85,500 and delivered in consummation of the sale the said certificates #4646, 4656, 4771, 4865, 4994, 5035, 5216, and 6616.”

The rules of the Board further provided, as they still do, (Rule 9, now Rule 14) that:

“After service upon him of the petition, the Commissioner shall have 60 days within which to file an answer or 20 days within which to move in respect of the petition. The answer shall be so drawn as fully and completely to advise the taxpayer and the Board of the nature of the defense. It shall admit or deny each material allegation of fact contained in the petition and set forth any new matters of fact and propositions of law upon which the Commissioner relies.”

and that (Rule 11, now Rule 17):

“The appeal shall be regarded as at issue upon the filing of the answer.”

The Commissioner thereupon on November 4, 1925, filed his answer (R. 9) in which his entire pleading on the facts was as follows:

“(1) Admits the allegations contained in paragraphs 1, 2 and 3 of the petition.

(2) With reference to the allegations contained in paragraph 5 of the petition, admits that during the years 1914 to 1917, inclusive, the taxpayer purchased various blocks of stock of the First National Bank of Boston and sold the same during the year 1920. Specifically denies that the total cost to the taxpayer of said stock so sold in 1920 was 120,637.50 and specifically denies that the total sales price of said stock so sold in 1920 was \$85,500.00.

(3) Specifically denies each, every and all allegations contained in taxpayer's petition not hereinabove expressly admitted to be true.”

Under the rules of the Board as cited above the original cost of \$120,637.50 and the selling price of \$85,500 as pleaded by the appellant were both specifically denied *and issue joined thereon*. No “new matters of facts * * * upon which the Commissioner relies” were pleaded then or by any subsequent amendment to the answer, although the Board’s rules in effect at the time of the trial (Rule 18) provided that:

“Upon motion made, the Board may, in its discretion, **at any time before the conclusion of the hearing**, permit a party to a proceeding to amend the pleadings to conform to the proofs.”

We submit that this record speaks for itself, and permits only one conclusion. The appellant pleaded a cost of \$120,637.50 and a selling price of \$85,500 (R. 6). The Commissioner in his answer specifically joined issue and denied this cost and this selling price, and did not set forth any other “new matters of fact” or in any way advise the taxpayer or the Board of any other or different defense (R. 9-10). The case came on for trial and the appellant proved the two facts on which issue had been joined, and the Board found as facts that the original cost was \$120,637.50 and the selling price 85,500 (R. 11). The Commissioner neither pleaded nor proved the alleged exercise of rights referred to in the agent’s report, but on the contrary went to trial on entirely different issues, *and lost on those issues*. Only one conclusion is possible, viz.—a loss for income tax purposes must in accordance with Sec. 202 of the Revenue Act of 1918, *supra* be allowed to the extent of the difference between the cost of \$120,637.50 and the selling price of \$85,500, those two figures having been finally and conclusively established by the pleadings, the proofs, and the Board’s findings of fact.

The opinion of the Board (R. 12) that—

“Upon the hearing counsel for the parties submitted in evidence the Bureau letter setting out the basis for the computation of the deficiency. The petitioner proved the sales price, the numbers of the certificates delivered, and the original cost of 300 shares evidenced by the certificates of stock which were delivered upon the sale and rested. The Commissioner then called to the stand the two witnesses who had testified on behalf of the petitioner and also counsel for the petitioner. Their testimony was to the effect that they did not know whether or not any rights to subscribe for stock had been issued in 1920 by the First National Bank of Boston to its stockholders, or whether petitioner had acquired any stock in 1920 by reason of the exercise of any such rights. Upon this record the deficiency determined by the Commissioner must be approved.

* * * * *

There was no dispute between the Commissioner and the petitioner as to the original cost of the stock acquired before 1920 or as to the selling price of the stock sold. The sole issue was whether the original cost was decreased by the exercise of stock rights in 1920. The Commissioner having found that there was such an exercise of stock rights and the petitioner having failed to submit any evidence upon the sole question in dispute, the petitioner has failed to establish a cost basis other than that determined by the Commissioner.”

is, in the light of this record, plain and obvious error. It shows on its face that it must have resulted from some misconception of the record, and should therefore be corrected. It is expressly based on premises directly contrary to the facts, viz.—that “there was no dispute” between the parties as to the original cost and

the selling price, whereas in fact the Commissioner in his answer specifically joined issue on and denied the appellant's allegations as to both those items (R. 9-10). It is impossible that "the sole issue" and "the sole question in dispute" was about an exercise of stock rights, when the pleadings made no reference of any kind to stock rights or any exercise thereof although the Board's rules required new matters of fact to be so pleaded in the answer.

That the Board's decision in the present case did result from some such misconception of the actual facts of the record, and not from any purpose to establish a rule of pleading or of evidence different from that for which we contend, is confirmed by examination of other decisions rendered by it both before and after its decision in the present case.

Thus in *Appeal of Buffalo Wills-Sainte Claire Corp.*, 2 B. T. A. 364, 365, the Board early held that it could not do what it has sought to do in the present case. It there said—

"The Board can not by surmise supply deficiencies in pleadings, for the pleadings must form the basis of its findings of fact. Where facts material and essential to a decision are omitted from the pleadings, the Board is powerless to remedy the defect."

and in *Appeal of W. L. Weaver*, 2 B. T. A. 709, 711, where *the Commissioner objected* to any allowance for depreciation "for the reason that the issue was not raised by the pleadings," the Board sustained his objection. It is indeed a poor rule that does not work both ways.

In *Crosswell v. Commissioner*, 6 B. T. A. 1315, 1320, a

case decided several months after the decision in the present case, the Board passed squarely and soundly on this whole question, as fully explained in the first paragraph of its opinion:

“The pleadings present but two issues for our determination, (1) whether the petitioner is entitled to personal service classification, (2) if such classification is denied, whether its profits tax should be computed under section 328. At the hearing and by brief, counsel for the petitioner suggested that if personal service classification is denied, then the actual value of its contract with the Coca-Cola Bottling Company, as of the date of incorporation, should be included in invested capital, but no motion to amend the petition so as to include this issue therein was made. The primary purpose of pleadings is the joinder of issues between the parties. Issues attempted to be raised by brief, or orally at the hearing, will be disregarded. *Appeal of Dixie Manufacturing Company*, 1 B. T. A. 641; *Appeal of W. P. Weaver, et al.*, 2 B. T. A. 709.”

It is submitted that the decision of the Board should be reversed because it erred in holding that the appellant has failed to establish a cost basis other than that determined by the Commissioner.

II. Even if a question of exercise of stock rights had been in issue, it would have been as an affirmative defense, the burden of pleading and proving which would have been on the Commissioner.

The possible effect of liquidating dividends, stock dividends, exercise of stock rights, etc., is an affirmative defense on the part of the Commissioner, and to hold otherwise would be utterly impractical.

In its opinion in the present case the Board also stated that:

“The original cost of stock is not necessarily the basis for determining profit and loss. This cost may be increased by the payment of assessments or decreased by liquidating dividends, stock dividends, or the exercise of rights to subscribe to stock, which rights the Supreme Court, in *Miles v. Deposit & Trust Co.*, 256 U. S. 247; 42 Sup. Ct. 483; 3 Am. Fed. Tax Rep. 3168, held to be essentially analogous to a stock dividend.”

We do not especially question that for purposes of such a basis the original cost may be decreased by liquidating dividends or by stock dividends (though as set forth in Point III of this brief we do very emphatically question that it may be decreased by an exercise of stock rights.) But we can not agree with the Board's apparent conclusion that the burden was on the taxpayer to disprove that there had been liquidating dividends, stock dividends, or (if, for the sake of argument only, we assume its relevancy) exercise of stock rights. To so hold is equivalent to holding that a *plaintiff* in a negligence case must prove that never *at any time in his life* had he been guilty of contributory negligence.

The concept of an affirmative defense is one well known to the law. As has been well said:

“When the form of pleadings is such that at the beginning the burden is cast upon the plaintiff and he establishes his *prima facie* case, the burden of answering such case must then be met by the defendant or the plaintiff prevails.” (Jones on Evidence, Sec. 179).

So here the statute (Revenue Act of 1918, Sec. 202) expressly recognized only two factors—cost and selling price. It provided that the basis for determining gain or loss from the “sale” of property shall be—“In the case of property acquired on or after that date, the *cost* thereof.”

The appellant pleaded as facts a cost and a selling price which, if proven, would have established his *prima facie* case. The Commissioner had two courses open to him. Either he could join issue and deny the cost or the selling price or both and thus force the taxpayer to prove them, or he could admit them and set up as affirmative defense “any new matters of fact” which he considered as an adequate defense, *e. g.*, the alleged exercise of rights in the present case. The record shows beyond any question that he chose the former course and that his answer contains not the slightest suggestion of exercise of stock rights or any other new matters (R. 9-10). The appellant *thus was forced to prove the cost and the selling price*, which he did, and having done so “the burden of answering such case must then be met by the defendant or the plaintiff prevails.”

The Commissioner, as conceded in the Board’s opinion, offered no evidence on this point and neither pleaded nor proved anything about any stock rights. Upon what ground then can it be held that, “Upon this record the deficiency determined by the Commissioner must be approved,” or that “the petitioner having failed to submit any evidence upon the sole question in dispute, the petitioner has failed to establish a cost basis other than that determined by the Commissioner?”

The best answer is again afforded by other opinions

of the Board itself, which show conclusively that it can not be so held.

In *Appeal of J. M. Lyon*, 1 B. T. A. 378, 379, the Board in ruling against the taxpayer said :

“Rule 20 of this Board provides that the burden of proof is on the taxpayer. That means that he must introduce sufficient evidence to make a *prima facie* showing that the Commissioner committed the errors alleged in the petition and to overcome the proofs submitted on behalf of the Commissioner. Such a showing must cover all the elements necessary to establish the averments of the petition. This Board is required by law to make findings of fact. Such findings can not be made upon conjecture, *ex parte* statements, or argument. They must be supported by evidence presented to the Board. What has been submitted to or considered by the Bureau of Internal Revenue is beyond the ken of this Board. This body is ‘an independent agency in the executive branch of the Government,’ it has no connection with the Bureau of Internal Revenue, and evidence that has been introduced before any other department of the Government must be reintroduced before this Board before we can consider it.”

and in *Appeal of Hunter Coal Co.*, 2 B. T. A. 828, where the taxpayer was contesting the Commissioner’s determination of depletion, the Board again sustained the Commissioner in the following terms:

“The Board is without any evidence as to the basis for depletion. The taxpayer offered the revenue agent’s report, to which the Commissioner objected and his objection must be sustained.”

It thus appears that this very same Commissioner who is the appellee in the present case has succeeded in convincing the Board that proceedings before it are *de novo* and *that neither a revenue agent's report nor other evidence submitted to his Bureau of Internal Revenue can be considered by the Board as evidence of the facts stated therein*. We ask him to meet this issue squarely and to explain to this Court, if he can, why this should not be equally binding on him in the case at bar. Indeed it is perhaps only fair to say that the Board itself must take full responsibility for its decision here and cannot pass it back to the Commissioner, for his counsel at the trial very properly did not even attempt to offer the agent's report as evidence of any facts alleged in it.

The Board has also had occasion to discuss the matter of affirmative defenses in cases before it, and its decision in *Appeal of General Lead Batteries Co.*, 2 B. T. A. 392, 395, shows that the same principles with respect thereto apply in pleading and practice before it as in the courts. In that case it said:

“At the time of the first hearing of this appeal, January 21, 1925, the taxpayer was allowed to file an amended petition wherein it set up error by the Commissioner in improperly including in 1919 income the amount of \$3,697.97. The answer thereto was filed on March 6, 1925. It was therein admitted that the taxpayer's contention as to the \$3,697.97 item was correct, but it was alleged:

The Commissioner says, however, that the net reduction of the taxpayer's net income for the year 1919 should be only \$727.53 inasmuch as the taxpayer has claimed among its deductions from gross income an amount of excessive depreciation in the sum of \$2,970.44.

No evidence whatsoever was introduced by the Commissioner in support of this allegation, and, obviously, the burden of proof thereof is upon him. The taxpayer's income for the year 1919 as determined by the Commissioner in arriving at the deficiency should be reduced by the amount of \$3,697.97."

In *Appeal of Harold B. Clarke*, 2 B. T. A. 555, 557, the Board in sustaining the taxpayer said:

"The transaction with the Columbia Trust Co. was on the border line, but the taxpayer's evidence establishes *prima facie*, a *bona fide* sale, and no evidence to rebut it has been presented by the Commissioner."

We believe that these decisions of the Board are sound and that, if so, they necessarily confirm our position in the present case. We venture to suggest that the Board's decision and opinion in the present case was inadvertent, and obviously due to some misconception of the record, an error which should therefore be corrected by this Court. We feel that this is all so obvious that further argument on this point is almost unnecessary, but before concluding its consideration we can not refrain from bringing to the Court's attention just one other aspect of this question.

We refer to the necessary implication in the Board's decision that such factors as "liquidating dividends, stock dividends, or the exercise of rights to subscribe to stock" must be affirmatively disproved by a taxpayer petitioning the Board rather than be raised as an affirmative defense. The very possibility of such a rule would be most effectively negated by its utter impracticability, all of which but confirms the sound-

ness of the well established rules of pleading and evidence which we have just considered. Indeed its impracticability is so great that it would demand the formulation of just such rules if they did not already exist.

A single illustration is sufficient, and we will take for that purpose the first one listed in the opinion, viz.—liquidating dividends.

What is the effect of a liquidating dividend? Perhaps the statement in the Commissioner's own regulations (Internal Revenue Regulations 69, Art. 1545) that:

“Distributions in liquidation.—Amounts distributed in complete liquidation of a corporation are to be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation are to be treated as in part or full payment in exchange for the stock so canceled or redeemed.”

is as good an answer as any. In any event for our present purposes we are satisfied with it if he is.

But when we turn to inquire what is—or perhaps it would be more accurate to say “when is”—a liquidating dividend, we find no such simple answer. On the contrary we must check over the entire financial history of the corporation and learn its exact financial condition at the time of the payment of *every* ordinary dividend. And then we have only started, for we must await the final decision of the Board or of the courts as to whether any one of many different sets of facts which we may happen upon does actually constitute a liquidating dividend.

Let us take a concrete illustration from the present

record, viz.—the 25 shares which the appellant purchased on January 19, 1914, for \$10,787.50 and held for over six years. During that six years the bank probably paid at least 24 regular quarterly dividends. If the burden of pleading and proving that there were no liquidating dividends is really on the petitioner, then he would have had to prove the condition of the bank's surplus on each of the 24 dates when these dividends were paid, for the Commissioner has ruled (and perhaps correctly) in G. C. M. 1552 (VI-19-3220) that—

“In the case of a corporation having no surplus either paid-in or earned, there can be no accumulation of profits until an operating deficit is made good. Where there was no surplus from which a dividend could have been paid by the corporation, held, a distribution by the corporation was a distribution of capital, and in accordance with section 201 (d) of the Revenue Act of 1926 should be applied against and reduce the basis of the stock in respect of which the distribution was made.”

and in Opinion 942 (Cum. Bul. 1919, p. 300) that even when there are sufficient earnings of the current year—

“Dividends paid while there is an operating deficit shall be deemed to be from capital or paid-in-surplus, even though there are earnings of the taxable year sufficient to pay the dividend in whole or in part.”

Let us pause and consider just what this means. It means that if the Board is right in its disposition of this case, the appellant would have had to prove that on April 1, 1914, or whatever was the date of the first dividend after he purchased his stock, the First National Bank had a surplus sufficient to pay the dividend.

He would then have had to prove the same thing for each subsequent dividend date. He would have had to subpoena practically all of the bank's general ledgers, one or more of its officers and employees, and in fact very generally inconvenience a third party having no interest in the case, and at the same time in presenting his evidence take up hours and days of the time of the Board, of opposing counsel, of disinterested witnesses, and of all concerned.

But that is only the starting point. For the question of what or when is a surplus as of *each one* of all those dividend dates is no simple one, but is itself in turn made up of a mass of difficult questions of law and of fact. Was there on *each one* of those dates a sufficient reserve set aside for taxes, and a sufficient reserve for depreciation, to mention only two classes of such questions? For this same Commissioner has held (Regulations 45, Art. 838) that—

“In the computation of earned surplus and undivided profits full recognition must first be given to all expenses incurred and losses sustained from the original organization of the corporation down to the taxable year, including among such expenses and losses reasonable allowances for depreciation, obsolescence, or depletion of property (irrespective of the manner in which such property was originally acquired), and for the amortization of any discount on its bonds. There can, of course, be no earned surplus or undivided profits until any deficit or impairment of paid-in-capital due to depletion, depreciation, expense, losses, or any other cause has been made good.”

and with respect to making allowance for taxes (Regulations 45, Art. 857) that—

“Method of determining available net income.

—Whether at the time of any payment made during the taxable year there is sufficient income of the taxable year available for such payment, or whether the surplus or undivided profits as of the beginning of the taxable year must be reduced by the amount of such payment, shall be determined according to the following principles:

(1) The aggregate amount of earnings of the taxable year available for all purposes up to any given date will be determined upon the basis of the same proportion of the net income for the taxable year (as finally determined for the purpose of income and war profits and excess profits taxes) as the part of the year already elapsed is of the entire year (determined in the manner provided in article 853), unless the corporation shows from its books or other records that a greater proportion of its earnings for the year was available on such date.

(b) The aggregate amount available will be deemed to be applied for the following purposes in the order in which they are stated: (a) accrued federal income and war profits and excess profits taxes for the taxable year (see article 845), and (b) dividends paid after the expiration of the first sixty days of the taxable year (see section 201 of the statute and article 1541) and other corporate purposes, including the purchase of outstanding stock of the corporation previously issued (see article 862). In any case where the above computation would be indeterminate because of the effect of the provisions of this article upon the invested capital for the year, the amount of such invested capital for the purpose of this computation may be deemed to be the invested capital as of the beginning of the taxable year, plus any additional capital paid in during such year and minus any specific withdrawal or liquidation of capital during such year.”

It is to be remembered that each of these tests must be applied as of *each one* of the 24 or more dividend dates, and if for any reason the records are inadequate the petitioner would be in danger of losing his case even though there might have been ample funds available at all times. Also that on some of the questions raised by these rulings the courts have not been unanimous, and the situation is generally confused.

Enough has been shown, however, to demonstrate how impracticable and impossible on the one hand, and unfair and unnecessary on the other hand, it would be to impose on the petitioning taxpayer the burden of disproving a myriad of fanciful facts that have nothing to do with the case. "It is a general principle that a pleading need and should not, by its averments, anticipate a defense thereto, and negative or avoid it." See 31 Cyc. 109, Sec 15, and the many cases there cited.

The inherent difficulty in proving a negative not only commends, but ordinarily requires the rule that the defendant or respondent in a case should have the affirmative of proving matters of defense and in avoidance.

In the present case there were presumably no liquidating dividends, and, if there had been any, the Commissioner whose duty includes the examination of the accounts of the First National Bank and of every other corporation in the country, was in a far better position than the petitioner to know of it, to plead it and to prove it. And the same is equally true of other factors which might operate to reduce the cost, the *prima facie* basis for computing gain or loss in case of sale of property acquired after March 1, 1913, as provided by Section 202.

The fundamental rules of pleading and evidence

evolved by the common law for courts which have general jurisdiction are equally applicable to and necessary in a special tribunal such as the Board. Only recently the Circuit Court of Appeals 'for the Seventh Circuit in reversing the Board's decision in the case of *Chicago Railway Equipment Co. v. Blair*, decided July, 1927, C. C. H. Tax Service, Par. 7225, held the Board to be bound by the ordinary rules of evidence in its consideration of cases. It may with equal force be said that the Board is likewise bound by the ordinary rules of pleading. The purpose of pleadings before any tribunal is to develop the issues for trial. As stated in 31 Cyc. 671:

“It is necessary that the parties, in the course of their pleadings, should finally come to issue on some single, certain, and material point in order that they may come to trial prepared with their evidence, and not be taken by surprise, and that the time of the court may not be consumed and the jury misled by the introduction of various irrelevant matters.”

In the present case the pleadings developed definite issues of fact and the appellant came to trial with his evidence prepared to meet those and only those issues. The simple fact is that, if the Commissioner had any defense at all, he failed to present it, and the orderly administration of justice requires that judgment must go to the party who to the full satisfaction of the tribunal (as conclusively demonstrated by the Board's findings of fact at R. 11-12) satisfied his burden of proof on the issues defined by the pleadings.

So far we have confined our argument to pleading and practice and have not discussed the substantive

merits of the case. We believe we are right on the position which we have taken up to this point and we ask this court to so decide, in which event it may pass directly to Point V of this brief. But we do not place our only reliance on these procedural matters, and if for any reason the Court finds itself unable to so decide, then we ask a decision on the merits, to the discussion of which in Points III and IV we now turn.

III. Even if an exercise of stock rights had been put in issue and proven, the original cost as a basis for determining gain or loss would not have been affected or decreased thereby.

For the reasons already set forth we submit that the judgment of the Board should be reversed and entered for the appellant, but even if the Board had been correct in its statement that "the sole issue was whether the original cost was decreased by the exercise of stock rights in 1920," and even if the record showed that stock rights had been so exercised (which it does not show), we now submit that on the merits the same conclusion should be reached by this Court.

The Board found (R. 11-12) that the Commissioner determined that prior to the sale the appellant exercised stock rights under which he purchased 300 additional shares of the same stock for \$30,000, and that the Commissioner determined the cost of the stock sold as follows:

"Cost of original 300 shares.....	\$120,637.50
Cost of 300 additional shares	30,000.00
Cost of 600 shares	\$150,637.50

Upon this basis the Commissioner determined the cost to the petitioner of the 300 shares sold to be \$75,318.75 and computed the deficiency accordingly."

At the very outset we are confronted with a glaring inconsistency on the face of the Board's own findings. How can we reconcile the "cost of original 300 shares \$120,637.50" with the statement a line or so further on that he had determined "the cost to the petitioner of the 300 shares sold to be \$75,318.75?" What is this difference of \$45,318.75 between what the Commissioner found to be the cost and what the Board found to be the actual cost? Had the appellant already recovered back \$45,318.75 of the original cost of the 300 shares evidenced by eight specified certificates of stock? No, there is not the slightest suggestion of anything of the sort. What is this \$45,318.75? No figure of \$45,318.75 is involved in the case at any point, and the absurdity of the entire proposal is apparent when we realize that the Commissioner's determination rests entirely on his contention—not that the appellant received anything back, either in money or in dividend stock—but *that he had spent \$30,000 additional for the purchase of more shares.*

The statute is clear and unambiguous. Section 202(a) of the Revenue Act of 1918 (40 Stat. 1060) expressly provides:

"Sec. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913 * * *

(2) In the case of property acquired on or af-

ter that date, *the cost thereof*; or the inventory value, if the inventory is made in accordance with section 203.”

It permits just one basis in a case such as the present. That basis is *cost*, and the Board itself has found that the cost of the 300 shares which were sold was \$120,637.50. That is all there is to it. It is just as unauthorized by law to theorize further as it is unnecessary. When the law is plain and unambiguous it is beyond the power of either administrative or judicial officers or tribunals to supplement it by construction. *United States v. Merriam*, 263 U. S. 179. If the Commissioner had pleaded in his answer an exercise of stock rights we would have raised this same question of law by objection to any offer of evidence in support thereof. But in the present case we had no opportunity to do so, nor was there any occasion for us to even refer to this question until after the final decision of the Board.

The Commissioner and the Board apparently rely on the single case cited by the Board—*Miles v. Safe Deposit & Trust Co.*, 256 U. S. 247. But examination of that case shows that it refers to a very different situation, and is no authority whatever for a position such as they have taken here.

In that case the taxpayer did not exercise the stock rights, but on the contrary sold them—a difference which is fundamental. In that case the taxpayer had income *coming in* from the sale of the rights, in the present case the taxpayer on the contrary *paid out* money for a capital investment. The cases are as far apart as the poles.

In the *Miles* case the original cost to the taxpayer of each share was \$710, and the right was to purchase one

new share for \$150. Instead of exercising the right, however, the taxpayer sold it for \$358.48, and the Commissioner held this entire "income" of \$358.48 to be taxable. The taxpayer claimed none of it was taxable. The district court, in an effort to give the taxpayer some relief, straddled the question and worked out a highly theoretical method of apportioning to the rights which were sold a part of the original cost. The Supreme Court, apparently for lack of any better method, did not disapprove it, but its opinion is very carefully and expressly limited to the facts before it and concludes almost apologetically that "upon the whole, we are satisfied that the method adopted by the district court led to a correct conclusion."

That method was as artificial as it was ingenious. The court made a rather violent assumption that the taxpayer received—not \$358.48 as he actually did—but \$358.48 plus the \$150 which the purchaser of the right had to pay to the corporation for the stock *and which the taxpayer never did receive*, or a total of \$508.48; that against this the taxpayer could deduct \$430 which is one-half of the sum of the cost of the original share at \$710 and the price of the new share at \$150 *which the taxpayer never did pay*; and that the difference of \$78.48 was taxable income.

There can be little wonder that the Supreme Court in its guarded approval of this method made it plain that it was limited to that particular set of facts, as it did at page 253—

"What would have happened had defendant in error decided to accept the new shares and pay the issuing price instead of selling the rights is of no consequence; in that event there would have been no realized profit, hence no taxable income.

What resulted or might have resulted to defendant in error's retained interest in the company, depending upon whether the purchaser exercised his right to subscribe or allowed it to lapse, or whether, in the latter event, the stock was sold by the directors, is of speculative interest only. Defendant in error resorted to the market for the sale of a part of its capital interest, concededly sold at an advance over cost, and what the profit actually was is the sole concern here; not whether it might have been more or less, nor whether the purchaser disposed of the stock to advantage."

Nor can there be any question that incidental expressions in the opinions which might possibly be claimed to apply to a case like the present where the rights were actually exercised are mere *obiter dicta*.

In the *Miles* case there was sold a right—a legally recognized species of property—which had no definitely established cost, and at the suit of a taxpayer the court felt itself obligated to work out as best it could some basis of cost. But that is a very different thing from the present case, where both the old and the new stock each have a definite and admitted cost (\$120,637.50 and \$30,000 respectively); where it is, not the rights, but one of these specific blocks of stock that is sold; and where the statute is specific in its requirement that "the cost" shall be used as a basis. In the *Miles* case the *cost was unknown*, and the court felt itself forced to work out some way for approximating it. That is very different from the present case where the *cost is known* to the penny and the courts can go no further in qualifying it, for to do so would require reading into the law something that is not there. Nothing is better established than that as so well said by

the Supreme Court in *Gould v. Gould*, 245 U. S. 151, 153:

“In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government, and in favor of the citizen. *United States v. Wigglesworth*, 2 Story, 369; *American Net & Twine Co. v. Worthington*, 141 U. S. 468, 474; *Banziger v. United States*, 192 U. S. 38, 55.”

In *Smietanka v. First Trust & Savings Bank*, 257 U. S. 602, 606, where the Income Tax Law of 1913 was silent as to the taxation of income accumulated in trust for unascertained beneficiaries and the Commissioner by ruling had held it taxable, that Court was even more emphatic in its declaration that:

“This seems to us to graft something on the statute that is not there. It is an amendment, and not a construction, and such an amendment was made in subsequent income tax laws, as we shall see.”

As has been well said by one lawyer who had occasion to express an opinion, the difference between the *Miles* case and the present case is really vital: in the one case, the Court is protecting the stockholder from a tax on what really does not constitute income at all, at least to the full extent of the cash received, by testing the nature of the transaction in its entirety, and finding the gain to be only apparent and accompanied by a shrinkage in value of the old shares; but in the

second case, the taxpayer for his own protection is relying on the language of the statute itself, which affords him full protection by the phrase—"shall be the cost of *such* property." There can be no merging of the two certificates, any more than in a case of purchases on two different dates at differing costs. The cost of the certificate actually selected for sale must govern. And in the event of the sale of the shares received under his subscription the tax thereon is increased to the same extent that the rule for which we contend reduces the tax on the sale of the old shares.

If the Commissioner in his argument sees fit to cite or rely upon the *Miles* case we venture to suggest that his discussion of the case be specific and not general, and especially that he show if he can, how the method there used could be applied in the present case, where the actual cost is known and admitted, without just such judicial legislation as the Supreme Court has condemned in the *Gould* and *Smietanka* cases. In fact we will go even further, and protest most vigorously that this particular Commissioner may not be heard to even cite the *Miles* case so long as he keeps in effect the regulation which we now proceed to discuss under Point IV.

IV. The Commissioner has himself in a recent regulation repudiated the method which was used in the Miles case and which he applied in the present case.

It has long been recognized in connection with the administration of our internal revenue laws that when a regulation which interprets a statute is changed without the change being occasioned by any new provision of the statute, the new regulations (which ob-

viously must be presumed to be the correct interpretation) speak from the effective date of the statute even though previously a different ruling had been promulgated (Commissioner's Ruling known as A. R. R. 8226, reported in Cumulative Bulletin III-2, page 116).

Shortly after the decision of the *Miles* case in 1922 the Commissioner changed his regulations to accord with what appeared to him to be the principle approved in that case, but in 1926 when he had occasion to promulgate a new set of regulations under the Revenue Act of 1926, in which act the statutory provision relative to cost as a basis remained unchanged (Revenue Act of 1926, Sec. 204, 44 Stat. —), he utterly repudiated the method which was embodied in those regulations and which he had applied in the present case, and in Article 39 of Regulations 69 ruled as follows:

“Where a corporation issues to its shareholders the right to subscribe to its stock, the value of the right does not constitute taxable income to the shareholder, but gain may be derived or loss sustained by the shareholder from the sale of such right.

Where the right to subscribe relates to new stock of substantially the same character or preference as the stock with respect to which the right is issued—

(1) If the shareholder does not exercise, but sells, his rights to subscribe, the cost or other basis of the stock with respect to which the rights are issued **shall be apportioned between the rights and the stock in proportion to the respective values thereof at the time the rights are issued**, and the basis for determining gain or loss from the sale of a right on one hand or a share of stock on the other will be the quotient of the cost or other basis assigned to the rights or the stock, divided,

as the case may be, by the number of rights issued or by the number of shares held.

(2) If the shareholder exercises his rights to subscribe, the basis for determining gain or loss from a subsequent sale of a share of the stock with respect to which the rights were issued shall be determined as in (1) above. The basis for determining gain or loss from a subsequent sale of a share of the stock obtained through exercising the rights shall be determined by dividing the part of the cost or other basis of the old shares assigned to the rights, plus the subscription price of the new shares, by the number of new shares obtained."

It is true that a few months ago in T. D. 4018 he ruled that in accordance with Section 1108 of the Act of 1926 (which provides that in case a regulation relating to the internal revenue law is reversed by a subsequent regulation and such reversal is not occasioned or required by a court decision the new regulation may be applied without retroactive effect) this new article 39 should be applied without retroactive effect. But that does not alter the fact that if it is a correct interpretation of Section 204 of the Revenue Act of 1926, it is by the same token the correct interpretation of the identically similar provisions of Section 202 of the Revenue Act of 1918, nor does it in any way prevent this Court from holding the earlier regulation which has been applied in the present case to be an incorrect interpretation of the law. Indeed we are utterly unable to understand how the present appellee can argue to this Court in support of the method he applied to this case when he himself has thus repudiated it. Nor do we believe that this Court will approve a method, which is not only open to the

objections which we have already pointed out, but which has now been repudiated by its own sponsor. A more persuasive argument can scarcely be found than this recent action on the part of the Commissioner.

Whether or not the new method now suggested by the Commissioner is any more correct than the old is neither here nor there, although we might add that for reasons already indicated we do not personally believe that it is any more sound. The old method, however, is the only one which has in any way been suggested in the present case, and the important consideration is that it is bad and utterly repudiated, and that the appellee by his action has agreed with us in that respect.

By his new regulation the Commissioner has confessed that the deficiency which he determined against the appellant is excessive. The record does not show the new factor brought in by his new regulations (the value of the right at the time it was issued), that being still another fact which, even if he considers it material, he failed to put in issue. But from the very nature of things the value of a right *at the time of its issuance* is ordinarily substantially less than the value of the stock to which it relates, so that it may well be presumed that the proportionate part of the original cost which would be attributed to the original stock—even under the Commissioner's latest guess as to the right way to do it, would be considerably greater than the proportion of little more than half the original cost which has been attributed to it in the determination from which this appeal is taken.

In any event, it seems to be agreed by both parties to the present case that the determination of the cost shown in the revenue agent's report, which has been

adopted by the Commissioner, is based upon an erroneous method, and it must be ruled therefore that the Commissioner erred in his determination and that the deficiency asserted by him must be disallowed. This is a point on which the Board of Tax Appeals has ruled squarely and we believe correctly in the *Appeal of the Acorn Refining Company*, 2 B. T. A. 250, 254, where it held that:

“On the record before us it would seem that the revenue agent’s adjustment is based upon an erroneous accounting theory. The examining revenue agent’s reports were introduced in evidence by the taxpayer and, since they show erroneous conclusions upon their face and form the basis of the Commissioner’s determination, we must find that the Commissioner erred in that determination and that the deficiency asserted by him is not well founded.”

We submit therefore that the Commissioner’s determination should be disapproved because as shown in Point III the loss should have been computed by a comparison of the original cost of \$120,637.50 and the selling price of ~~\$75,318.75~~ ^{85,500}, and also because as shown in Point IV the Commissioner stands self-confessed that his determination was based upon an erroneous method.

V. The decision of the Board should be reversed and final judgment entered for the appellant.

The power and jurisdiction of this Court in the present case is full and complete, as expressly defined in Section 1003 of the Revenue Act of 1926 (44 Stat. 110) which provides:

“(a) The Circuit Court of Appeals and the Court of Appeals of the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board (except as provided in section 239 of the Judicial Code, as amended); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 240 of the Judicial Code, as amended.

(b) Upon such review, **such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.**”

For each of the reasons already set forth in this brief we submit that “the decision of the Board is not in accordance with law” within the meaning of the section just quoted. If then this Court agrees with us on any or all of those reasons ~~it~~ has full power to modify or reverse that decision without remanding the case for a rehearing.

In this connection we venture to suggest that there would be neither occasion nor opportunity to remand for a rehearing as the record already presents all the facts essential for the revised determination of the tax and the entry of final judgment. The method by which the deficiency of \$22,372.66 originally proposed by the appellee was computed is shown at R. 18-22 and 7-8; his reduction of the deficiency to \$21,310.58 is shown at R. 8-9; and the reduction of income in question in the present case (viz., \$45,318.75) is shown at R. 19. If our position on any of the three major questions is sustained, the deficiency should therefore be redetermined as follows:

Net income subject to surtax according to revised letter of October 5, 1925, (R. 8-9)	\$117,079.16
Less	45,318.75
Revised net income.....	71,760.41
Surtax on \$71,760.41.....	11,808.54
Less tax paid at source (R. 22).....	581.71
Balance of tax due.....	11,226.83
Previously assessed (R. 22).....	10,498.87
Revised deficiency	727.96

In conclusion therefore we submit that the profit or loss on the sale of the stock must in the present case be determined by comparing the selling price with the original cost; that no alleged exercise of stock rights is in issue, and if it were in issue it would not be relevant; that the appellant fully satisfied his burden of proof; that the decision of the Board should be reversed; and that the deficiency should be redetermined in the amount of \$727.96 and final judgment to that effect entered by this Court.

Respectfully submitted,

JAMES CRAIG PEACOCK,
JOHN W. TOWNSEND,
Attorneys for Petitioner.

WHEATON KITTREDGE,
Of Counsel.

DEC 16 1927

Henry M. Hodges

No. 4627

Blunt

**In the Court of Appeals of the District of
Columbia**

OCTOBER TERM, 1927

FREDERICK AYER, APPELLANT

v.

**DAVID H. BLAIR, COMMISSIONER OF INTERNAL
REVENUE, APPELLEE**

**ON REVIEW OF DECISION OF THE UNITED STATES BOARD
OF TAX APPEALS**

**BRIEF FOR THE COMMISSIONER OF INTERNAL REVENUE,
APPELLEE**

MABEL WALKER WILLEBRANDT,
Assistant Attorney General.

C. M. CHAREST,
General Counsel, Internal Revenue.

JOHN W. FISHER,
Special Attorney, Bureau of Internal Revenue.

INDEX

	Page
Statement of the case-----	1
Argument:	
I. In determining gain derived or loss sustained from the sale of shares of capital stock with respect to which subscription rights have been issued and exercised, it is necessary to combine the cost of the old and new shares and consider them together in arriving at the basis to be used for determining gain or loss from the sale of the old shares, and the method of computation used by the Commissioner in this case was correct-----	8
II. Either, on the one hand, the acquisition of new stock by the exercise of stock rights with respect to the shares of stock sold by the taxpayer and the effect thereof on the determination of gain or loss from the sale in question were in issue before the Board in this case and the Commissioner's determination must be approved because the taxpayer failed to sustain the burden of proof which was his to show error in the Commissioner's determination; or, on the other hand, such acquisition of new stock by the exercise of stock rights and the effect thereof on gain or loss were not in issue, and the Board could find as facts nothing more than the original cost of the old shares and their selling price, leaving unaffected the prima facie case established by the Commissioner's determination as to the acquisition of stock by the exercise of stock rights by the taxpayer, and the effect thereof in the determination of gain or loss from the sale of the old shares-----	20
Conclusion-----	48

AUTHORITIES CITED

Cases:	
<i>Becker v. Commissioner</i> , 8 B. T. A. 65-----	44
<i>Buffalo Willis-Sainte Claire Corporation, Appeal of</i> , 2 B. T. A. 364-----	38
<i>Capitol Securities Co., Appeal of</i> , 3 B. T. A. 75, 76-----	31
<i>Connorized Music Co. v. Commissioner</i> , 7 B. T. A. 213, 215--	32
77188—27—1' (1)	

II

Cases—Continued.

	Page
<i>Crosswell v. Commissioner</i> , 6 B. T. A. 1315-----	38
<i>Davis & Shaw Furniture Co. v. Commissioner</i> , 6 B. T. A. 705, 707-----	29
<i>Douglas, Appeal of</i> , 1 B. T. A. 372-----	25
<i>Eimer & Amend, Appeal of</i> , 2 B. T. A. 603-----	25
<i>Eisner v. Macomber</i> , 252 U. S. 189-----	12, 14
<i>Findlay Dairy Co., Appeal of</i> , 2 B. T. A. 917-----	25
<i>General Lead Batteries Co., Appeal of</i> , 2 B. T. A. 392, 394--	41, 42
<i>Gottlieb Bros., Appeal of</i> , 1 B. T. A. 684, 687-----	26
<i>Hart, Appeal of</i> , 4 B. T. A. 254, 255-----	30
<i>Hughes Coal Co. v. Commissioner</i> , 8 B. T. A. 306-----	43
<i>Huyler's v. Commissioner</i> , 8 B. T. A. 13, 40-----	44
<i>Kennedy Construction Co., Appeal of</i> , 4 B. T. A. 276, 279--	32
<i>Lyon, Appeal of</i> , 1 B. T. A. 378, 379-----	24
<i>Mallinakrodt, Appeal of</i> , 4 B. T. A. 1112-----	15
<i>Mandel Bros., Appeal of</i> , 4 B. T. A. 341, 355-----	30, 34
<i>Manville Jenckes Co., Appeal of</i> , 4 B. T. A. 765, 803-----	32, 43
<i>Miles v. Safe Deposit & Trust Co.</i> , 259 U. S. 247-----	6,
8, 9, 11, 12, 13, 15, 16, 18	
<i>Perot's Francis, Sons Malting Co., Appeal of</i> , 1 B. T. A. 562-----	25
<i>Piedmont-Mt. Airy Guano Co. v. Commissioner</i> , 8 B. T. A. 72-----	43
<i>Pleasant Valley Ranch Co., Appeal of</i> , 2 B. T. A. 335-----	27
<i>Roffwarg, Appeal of</i> , 2 B. T. A. 332-----	25
<i>Sentinel Publishing Co., Appeal of</i> , 2 B. T. A. 1211, 1216--	26
<i>Standard Marine Insurance Co., Ltd., Appeal of</i> , 4 B. T. A. 853, 866-----	25
<i>Sweetwater, Bank of, Appeal of</i> , 2 B. T. A. 621-----	28, 34
<i>Towne v. McElligott</i> , 274 Fed. 960-----	14, 19
<i>Weaver, Appeal of</i> , 2 B. T. A. 709-----	38
Other authorities:	
Regulations 45 (1920 ed.), article 1547-----	12
Regulations 69, article 39-----	18
Revenue Act of 1926, section 1000, amending Title 9 of the Revenue Act of 1924, section 907(a) (44 Stat. L. 107)---	24
Revenue Act of 1926, section 1108(a)-----	17
Rules of Practice of Board of Tax Appeals, Rule 5-----	21, 22
Rules of Practice of Board of Tax Appeals, Rule 9-----	22
Rules of Practice of Board of Tax Appeals, Rule 14-----	22
Rules of Practice of Board of Tax Appeals, Rule 30-----	24
Rules of Practice of Board of Tax Appeals, Rule 50-----	40
Treasury Decision 3402, I-2 Cumulative Bulletin 63, 64----	8
Treasury Decision 4018, Internal Revenue Bulletin, Vol. VI, No. 23, p. 2-----	17

In the Court of Appeals of the District of Columbia

OCTOBER TERM, 1927

No. 4627

FREDERICK AYER, APPELLANT

v.

**DAVID H. BLAIR, COMMISSIONER OF INTERNAL
Revenue, appellee**

***ON REVIEW OF DECISION OF THE UNITED STATES BOARD
OF TAX APPEALS***

BRIEF FOR APPELLEE

STATEMENT OF THE CASE

This case presents two questions: (1) Whether in computing the gain or loss derived from the sale of shares of capital stock with respect to which subscription rights have been issued and exercised, it is necessary to take account of the issue and exercise of such rights, and if so, how such account shall be taken, and (2) If it is held to be necessary as a general rule to take account of the issue and exercise of such rights, whether the circumstances of the pres-

ent case are such as to prevent such account being taken notwithstanding the general rule.

The parties will be referred to as taxpayer and Commissioner.

The taxpayer's petition filed with the Board of Tax Appeals sets forth that the determination of tax contained in the deficiency letter was based upon error in not determining a loss on the sale on December 7, 1920, of 300 shares of stock of the First National Bank of Boston, by taking the difference between the selling price of \$85,500 and the cost of the said shares which was \$120,637.50. As facts upon which the taxpayer relied as the basis of his appeal, it was stated in substance that during the years 1914 to 1917, inclusive, the taxpayer purchased various blocks of stock of the First National Bank of Boston, totaling 300 shares, at a cost to him of \$120,637.50; that the ownership of these shares was evidenced by 8 certificates of stock; and that on December 7, 1920, the taxpayer sold the said 300 shares for \$85,500 and upon such sale, delivered the 8 certificates referred to. The petition further sets forth as a proposition of law that under Section 202(a)(2) of the Revenue Act of 1918 the basis for determining the gain or loss on the sale of 300 shares on December 7, 1920, was the cost of the said 300 shares, viz, \$120,637.50. (R. 6, 7.)

Attached to the taxpayer's petition was a copy of the deficiency notice mailed to the taxpayer by the Commissioner under date of August 27, 1925 (R. 7), and also a copy of a subsequent letter of the

Commissioner dated October 9, 1925, making certain adjustments not affecting the questions here presented (R. 8).

The Commissioner's answer admitted the purchase of the stock substantially as alleged in the petition, but denied that the total cost to the taxpayer of said stock was as alleged, and denied that the total sale price was as alleged. It also contained a statement that the Commissioner specifically denied each, every and all allegations contained in taxpayer's petition not expressly admitted in the answer to be true. It also asserted as a proposition of law that the taxpayer's loss from the purchase and sale of stock had been correctly computed in accordance with Section 202 of the Revenue Act of 1918. (R. 9, 10.)

At the hearing before the Board, there was introduced in evidence a copy of the Commissioner's letter to the taxpayer dated March 14, 1924 (Taxpayer's Ex. 1, R. 24), which was referred to and incorporated by reference in the deficiency letter of August 27, 1925. There was also introduced in evidence a copy of the report of the revenue agent dated December 22, 1923 (Joint Ex. A, R. 18), which was referred to and incorporated by reference in the letter of March 14, 1924. The revenue agent's report was received in evidence for the purpose of showing how the Commissioner computed the deficiency. (R. 25.) The revenue agent's report contains statements and schedules showing in detail the changes made

by the revenue agent in the items of income as reported by the taxpayer and the computation of the tax. In particular, it contains a statement showing the computation by the revenue agent of the profit derived by the taxpayer from the sale of the First National Bank stock above referred to. (R. 19, 22.) In his set-up of this computation, the revenue agent stated that in 1920 the bank offered one new share of its stock at \$100 for each old share, and that the taxpayer exercised his rights and purchased 300 new shares in April, 1920, for \$30,000. In computing the profit from the sale of the 300 old shares, the revenue agent added to the original cost of the old shares the amount of \$30,000 paid for the new shares, making the total cost of the 600 shares \$150,637.50, and thereupon computed the basis for determining the profit from the sale to be one-half of the cost of the 600 shares, or \$75,318.75. The taxpayer had returned a loss from this transaction based on a cost of the old shares of \$120,637.50 without any adjustment for the new shares acquired by the exercise of the stock rights, and the revenue agent adjusted the taxpayer's income as returned by computing a profit on the basis above set forth. The Commissioner's letters in evidence show that the Commissioner adopted the revenue agent's computation as his determination with respect to the sale in question.

Two witnesses were called by the taxpayer. These witnesses identified the certificates of stock

and testified to the original cost and the sale price of the shares evidenced by the certificates. The taxpayer then rested. The Commissioner thereupon called to the stand the two witnesses who had testified for the taxpayer and also the taxpayer's counsel, and questioned these three witnesses with respect to their knowledge of any stock rights issued to the taxpayer. These witnesses testified that they had no knowledge as to any such rights, except that the taxpayer's attorney stated that he had seen the revenue agent's report (Joint Ex. A), that he had had that report for several years, and that it probably had been sent or given to him by the taxpayer's Boston attorney. He further testified that he had not conversed or corresponded with the taxpayer's Boston attorney about the facts as to any such rights, because they had taken the position that such facts were not relevant and that the only relevant facts were those relating to the original cost of the stock which was sold. No objection was made in behalf of the taxpayer to any of these questions. (R. 25-28.)

The Board found as facts that prior to January 1, 1920, the taxpayer had acquired 300 shares of stock of the First National Bank of Boston at a cost of \$120,637.50; that the ownership of this stock was evidenced by 8 certificates of stock; that on December 6, 1920, the taxpayer sold 300 shares of the stock of the First National Bank of Boston for \$85,500 and upon such sale delivered the 8 cer-

tificates of stock referred to; and that the Commissioner determined that in 1920, the bank offered to its stockholders one new share at \$100 for each share then held, determined that the taxpayer exercised his rights and purchased, in April, 1920, 300 shares of the capital stock of the First National Bank of Boston for \$30,000, determined that the cost of the taxpayer's stock was therefore \$150,637.50, and upon this basis determined that the cost to the taxpayer of the 300 shares sold was \$75,318.75 and computed the deficiency accordingly. The Board stated in its opinion that the issue before the Board was whether the original cost of the stock was decreased by the exercise of stock rights in 1920; that the Commissioner had found that there was such an exercise of stock rights; and that the taxpayer had failed to submit any evidence on this question. The Board, therefore, held that the petitioner had failed to establish a cost basis other than that determined by the Commissioner, and on the authority of *Miles v. Safe Deposit & Trust Company*, 259 U. S. 247, entered its decision for the Commissioner.

The taxpayer contends that the acquisition and exercise of stock rights or the effect thereof upon the determination of gain or loss from the sale in question was not in issue; that the taxpayer had satisfied any burden of proof resting upon him by the proof which he offered at the hearing; and that even if it had been proved that stock rights had been issued to and exercised by the taxpayer with respect

to the shares sold, this fact would not affect in any way the gain or loss from the sale, and that in any event, the method used by the Commissioner in computing the profit was erroneous.

The Commissioner's position is that in computing gain or loss from the sale of shares of stock with respect to which stock rights have been issued and exercised, the cost of the old and the new shares must be combined and considered together to determine the basis upon which gain or loss shall be determined, and that the method of computation used by the Commissioner in this case was correct; and that either, on the one hand, the acquisition and exercise of stock rights with respect to the shares of stock sold by the taxpayer and the effect thereof in determining gain or loss were in issue in this case, and the Commissioner's determination must be approved because the taxpayer failed to sustain the burden of proof which was his to show error in the Commissioner's determination; or, on the other hand, such acquisition and exercise of stock rights and the effect thereof on gain or loss were not in issue, and the Board could find as facts nothing more than the original cost of the old shares and their selling price, leaving unaffected the prima facie case established by the Commissioner's determination as to the acquisition and exercise of stock rights by the taxpayer and the effect thereof in determining gain or loss from the sale of the old shares.

ARGUMENT

1. In determining gain derived or loss sustained from the sale of shares of capital stock with respect to which subscription rights have been issued and exercised, it is necessary to combine the cost of the old and new shares and consider them together in arriving at the basis to be used for determining gain or loss from the sale of the old shares, and the method of computation used by the Commissioner in this case was correct.

In determining the profit derived by the taxpayer from the sale in question, the Commissioner followed the rule laid down in Treasury Decision 3402, I-2 Cumulative Bulletin 63, 64, promulgated October 18, 1922, as follows:

Where the stockholder exercises his right to subscribe to new stock of substantially the same character or preference as the stock with respect to which the right is issued, the cost of the old and new shares (or, if acquired prior to March 1, 1913, the fair market value as of that date) will be the quotient of the cost of the old shares, plus the subscription price of the new shares divided by the total number of the old and the new shares.

This ruling of the Treasury Department was occasioned by the decision of the United States Supreme Court in *Miles v. Safe Deposit & Trust Co.*, 259 U. S. 247. Following the rule formerly recognized, the Commissioner had taxed the stockholder in that case on the entire amount of the sale price of certain stock rights issued with respect to stock owned by him. The taxpayer contended that no part of such sale price constituted income. The Supreme Court held that if a profit was derived from the sale of such rights, such profit was taxable,

and approved the method adopted by the lower court of determining such profit. The lower court had combined the cost of one of the old shares with the cost of a new share acquired through the exercise of the rights and had taken one-half of the sum as the basis for each of the rights.

The present taxpayer argues, however, that the cost of stock rights or of new stock acquired by the exercise of stock rights has no effect whatever upon the basis for determining gain or loss from the sale of the old shares, and that this question is not affected by the decision in *Miles v. Safe Deposit & Trust Company*, because there is an essential difference between a sale of the rights and a sale of the old shares. He says (Brief 27) that in the Miles case the taxpayer had income *coming in* from the sale of the rights, while in the instant case, he *paid out* money for a capital investment.

The taxpayer has apparently wholly misconceived the effect of the Supreme Court's decision in *Miles v. Safe Deposit and Trust Company*. He refers to the Supreme Court's "guarded approval" of the method used by the lower court. There is nothing, however, guarded or hesitating or ambiguous in the language used by the Supreme Court in its statement of the principles upon which any correct method must be based. The Court said, at page 253:

How the gain should be computed is a matter of some contention by the Government in this court; but *it admits of little*

doubt. *To treat the stockholder's right to the new shares as something new and independent of the old, and as if it actually cost nothing, leaving the entire proceeds of sale as gain, would ignore the essence of the matter, and the suggestion can not be accepted.* The District Court proceeded correctly in treating the subscription rights as an *increase inseparable from the old shares*, not in the way of income but as capital; in treating the new shares if and when issued *as indistinguishable legally and in the market sense from the old*; and in regarding the sale of the rights as *a sale of a portion of a capital interest that included the old shares.* (Italics ours.)

If, in such a case, the rights are not something new and independent of the old shares, if they are an increase inseparable from the old shares, if they are indistinguishable legally and in the market sense from the old shares, and if a sale of such rights is a sale of a portion of a capital interest that includes the old shares, then it must also be true that the old shares are not independent of the rights or of the new shares, that the old shares are inseparable from the increase represented by the rights, that the old shares are indistinguishable legally and in the market sense from the new shares, and that a sale of the old shares is a sale of a portion of a capital interest that includes the new shares.

There can be no escape from such a conclusion and it follows by inexorable logic that the profit from the sale of the old shares can not be determined without taking account of the subscription rights or the new shares. If the lower court in its computation of the profit in that case made a "violent assumption," as the taxpayer asserts, or any number of them, it can hardly be doubted that the Supreme Court's approval fully warrants similar violent assumptions in a case presenting the same typical problem.

The Supreme Court in the *Miles case* approved a method of computing profit from the sale of stock rights, which involved the taking away of a part of the original cost of the old shares and transferring it to the new shares to form a part of the basis for determining gain or loss from a sale of the rights. Can it be seriously contended that such taking away and transfer from the old shares to the new does not affect permanently the basis for the old shares, and after such taking away and transfer, is it possible to say that the basis for determining gain or loss from a sale of the old shares remains unchanged? And if such taking away and transfer from the old shares to the new was necessary when the rights or the new shares were sold, it follows that it is equally necessary if the old shares are sold before the new. Nothing less than this can satisfy the requirements of the principle so clearly stated by the Supreme Court in the *Miles case*, that the

old shares and the rights or the new shares form one inseparable, indistinguishable capital interest.

In the *Miles case* the Supreme Court said also, at page 252:

The stockholder's right to take his part of the new shares therefore—assuming their intrinsic value to have exceeded the issuing price—was essentially analagous to a stock dividend.

The Supreme Court also quoted Article 1547 of Regulations 45 (1920 ed.) relating to stock dividends, as follows:

Stock in a corporation received as a dividend does not constitute taxable income to a stockholder in such a corporation, but any profit derived by the stockholder from the sale of such stock is taxable income to him. (Following *Eisner v. Macomber, supra*, 252 U. S. 189.) For the purpose of ascertaining the gain or loss derived from the sale of such stock, or from the sale of the stock with respect to which it is issued, the cost (used to include also, where required, the fair market value as of March 1, 1913), of both the old and the new shares is to be determined in accordance with the following rules:

(1) Where the stock issued as a dividend is all of substantially the same character or preference as the stock upon which the stock dividend is paid, the cost of each share of both the old and new stock will be the quotient of the cost, or fair market value as of March 1, 1913, if acquired prior to that

date, of the old shares of stock divided by the total number of the old and new shares. * * *

The Supreme Court observed that the method adopted by the lower court in the *Miles case* was in essence the method provided for in this article of the Regulations, and then said:

That the averaging of cost might present more administrative difficulty in a case more complicated than the present, as where the old shares were acquired at different times, is not a sufficient ground for denying the soundness of the method itself.

It is to be observed that in quoting the Regulations the Supreme Court included in its quotation the portion which applied to the ascertainment of gain or loss derived from the sale of the old stock, as well as that which applied to the sale of the new stock issued with respect to the old.

It is to be observed also that in the *Miles case* the sale was made in July, 1919, and that therefore the Revenue Act of 1918, the same Act as is involved in the instant case, was the controlling Act.

It is unhesitatingly asserted that the *Miles case* not merely supports, but positively requires, a method of computing gain or loss from a sale of old stock with respect to which rights to new shares have been exercised which combines the cost of the old and the new. Moreover, it supports exactly the method used by the Commissioner in the instant case. There is also other authority for this method.

In the case of *Towne v. McElligott*, 274 Fed. 960 (Dist. Ct. So. Dist. N. Y.), Judge Learned Hand was considering a case in which it appeared that the plaintiff, prior to March 1, 1913, owned shares in a corporation, and bought other shares thereafter. Later he received a stock dividend of 50% upon all his shares. In 1918 he sold the shares owned on March 1, 1913, those purchased afterward, and a portion of those received by dividend, and the taxing authorities combined all of his shares and averaged the cost to determine his profit. The plaintiff argued that he should be credited with the actual cost of each certificate, computing the cost of the shares declared as a stock dividend at nothing. The court said, at page 962:

The second point is raised by *Eisner v. Macomber*, 252 U. S. 189, 40 Sup. Ct. 189, 64 L. Ed. 521, 9 A. L. R. 1570, and must be ruled by its implications. Under the doctrine of that case a stock dividend is not regarded as new property at all. The old certificate represented precisely the same property as the old and new do thereafter. The old shares have proliferated, as it were, and although the right they represented has now suffered a cellular division into smaller units of greater number, that is all that has happened. In view of this, it seems to me difficult to avoid regarding the old and new shares together as anything more than the evidence of a right which has persisted unchanged through the declaration of the dividend. It might have been possible to look at

the new shares as declared from the surplus, and the surplus as not included in the old shares (at least not in the same sense as the new shares comprise it); but all such notions were expressly repudiated in the prevailing opinion. If so, *each of the new shares, whether contained in the old or the new certificate, represents a part of the original property purchased and in selling the first certificate, the stockholder has not sold the whole of what he originally bought, and should not be credited with the whole purchase price.* Judge Rose, in *Safe Deposit, etc., Co. v. Miles* (D. C.), 273 Fed. 822, has adopted the same theory of computing an income tax in a stronger case. There the plaintiff sold some "rights" declared upon his stock, and Judge Rose computed his profit in substantially the same way as I suggest here. (Italics ours.)

In the case just cited the plaintiff was making exactly the same contention as to the effect of stock acquired by stock dividend that the taxpayer in the instant case is making with respect to stock acquired by the exercise of stock rights, and since the Supreme Court in *Miles v. Safe Deposit & Trust Company, supra* (259 U. S. 247), considered stock rights as essentially analagous to a stock dividend, the cited case is directly in point as authority in the instant case.

The Board of Tax Appeals in *Appeal of Malinckrodt*, 4 B. T. A. 1112, draws the same conclu-

sion from the Supreme Court decision in the *Miles* case. In that case the Board said, at page 1119:

The petitioner acquired the 75 shares of the Mechanics Bank stock by the exercise of a stockholder's right to purchase same at a given price less than their true value. For the purpose of ascertaining whether a gain or loss results from the future disposition of such stock all the shares held, including the 300 formerly held and the 75 shares acquired, must be treated as one property and the rule laid down in the case of *Miles v. Safe Deposit & Trust Company*, 259 U. S. 247, 252, 253, is controlling in respect of this phase of this case.

The taxpayer makes some point of the fact that the Commissioner's regulations have been changed so that he no longer follows the same rule in computing the gain or loss derived from the sale of stock where stock rights are involved. It is true that the rule for the ascertainment of such gain or loss has been modified. (See Article 39, Regulations 69.) There are cases, however, where the new rule and the old give the same result. If the rights and the stock have the same value at the time the rights are issued, the result will be the same, and it is not to be presumed that the result will be different. Even, therefore, if the new regulations were to be applied, it would not follow in the absence of proof that there was error in the Commissioner's determination, and the burden was upon

the taxpayer, as will be pointed out later in this argument, to show that there was such error in the Commissioner's determination.

The real answer to this point, however, is suggested by the taxpayer himself in his brief when he observes that this new provision of the Regulations, was by express ruling of the Commissioner with the approval of the Secretary of the Treasury, to be applied without retroactive effect. Section 1108(a) of the Revenue Act of 1926 provides as follows:

In case a regulation or Treasury decision relating to the internal-revenue laws, made by the Commissioner or the Secretary, or by the Commissioner with the approval of the Secretary, is reversed by a subsequent regulation or Treasury decision, and such reversal is not immediately occasioned or required by a court of competent jurisdiction, such subsequent regulation or Treasury decision may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect.

Pursuant to this statutory authority, the following Treasury Decision (No. 4018, Internal Revenue Bulletin, Vol. VI, No. 23, p. 2) was promulgated:

Section 1108(a) of the Revenue Act of 1926 provides that in case a regulation relating to the internal-revenue laws is reversed by a subsequent regulation and such reversal is not immediately occasioned or required by a decision of a court of competent jurisdiction,

such subsequent regulation may, in the discretion of the Commissioner, with the approval of the Secretary, be applied without retroactive effect. Article 39 of Regulations 69, accordingly, will not be applied retroactively and is applicable only to sales of stock or rights within the terms thereof taking place on or after January 1, 1925, the effective date of the Revenue Act of 1926.

In view of the fact that the method of computing the profit used by the Commissioner in the instant case had the approval of the Supreme Court in the case of *Miles v. Safe Deposit & Trust Company, supra* (259 U. S. 247), where it was said that the method led to a correct result, there seems no reason to doubt that it was a reasonable method and that it was properly applied in the instant case.

The taxpayer makes some point of the fact that the cost of the rights was unknown in the *Miles case*, and that this was the reason that the court felt obligated to work out some basis of cost as best it could. It is to be observed, however, that the Supreme Court treats the right as representing the new stock, and approves the computation in which the cost of each share of the total aggregate is computed in the same way as if the rights had been exercised and new shares actually acquired. This is evidently one of the assumptions which the taxpayer characterizes as "violent," but, as has already been suggested, in view the fact that it has received the sanction of the Supreme Court, no apology is

needed for recognizing the propriety of such an assumption. Moreover, the fact that the Supreme Court recognizes the essential analogy between stock rights and stock dividends indicates that if the contention of the taxpayer in the instant case were sound the rights themselves would be treated as having cost nothing, and this was the contention actually made with respect to dividend stock in the case of *Towne v. McElligott*, *supra* (274 Fed. 960). Consequently there is no basis whatever for the view that either the lower court or the Supreme Court felt driven to the method actually adopted because of any uncertainty as to the cost of the rights.

It is submitted therefore that in any case where stock rights have been issued, no correct computation of profit from the sale of the stock with respect to which the rights were issued can be made without taking such rights into consideration, and that the old stock, and the rights and the new stock, are to be treated as a single capital interest. It is further submitted that the method used in this case by the Commissioner and approved by the Board, being in accordance with the Regulations in effect at the time of this transaction, and in accordance with the decisions of the Supreme Court and lower courts, was a proper method.

2. Either, on the one hand, the acquisition of new stock by the exercise of stock rights with respect to the shares of stock sold by the taxpayer and the effect thereof on the determination of gain or loss from the sale in question were in issue before the Board in this case and the Commissioner's determination must be approved because the taxpayer failed to sustain the burden of proof which was his to show error in the Commissioner's determination; or, on the other hand, such acquisition of new stock by the exercise of stock rights and the effect thereof on gain or loss were not in issue, and the Board could find as facts nothing more than the original cost of the old shares and their selling price, leaving unaffected the prima facie case established by the Commissioner's determination as to the acquisition of stock by the exercise of stock rights by the taxpayer, and the effect thereof in the determination of gain or loss from the sale of the old shares.

In view of the excellent authority for the position that the acquisition of new stock by the exercise of stock rights does affect the computation of gain or loss from the sale of the stock with respect to which the rights were issued, it might be thought that, even if the law were believed to be otherwise, good faith with the Government would have called for the submission to the tribunal established by Congress especially to hear and determine tax controversies, of all of the facts bearing upon the question, the issue then being one of law as to what effect, if any, the exercise of such rights should have. This aspect of the case, however, is passed without further comment.

The taxpayer assigned error on the part of the Commissioner in not determining a loss on the sale in question "by taking the difference between the selling price of \$85,500 and the cost of the said shares which was \$120,637.50." Involved in this assignment are three issues: (1) The amount of the selling price, (2) the amount of the cost, and (3)

the method of computing the loss (or gain). The allegation of error is made with respect to the Commissioner's determination, which is the starting point for every case. Rule 5 of the Board's Rules of Practice provides that a copy of the notice of deficiency shall be appended to the petition, and where, as in this case, the letter is not itself complete, but refers back to and incorporates previous letters or reports, such letters and reports are received by the Board as a matter of course to show what the determination of the Commissioner was. In every case the Board must be informed as to what the Commissioner did or it will not decide that he erred, as the Board's decisions hereinafter cited will show, and as these cases will also show, it is the taxpayer and not the Commissioner who loses if the Board's information as to what the Commissioner did is insufficient. The taxpayer's assignment of error, therefore, clearly raised an issue as to whether the Commissioner erred as a matter of law in the method of his computation. The Board's practice does not require that issue be taken on the assignments of error, any more than the practice of the courts so requires, but if any issue were needed, it was sufficiently raised by the Commissioner's denial which has already been referred to of all allegations not admitted.

In his allegations of fact the taxpayer stated facts relating only to the original cost of the stock and the selling price, which indicated still more clearly that the issue as to the method of computation was

one of law. With these allegations of fact, the Commissioner's answer took direct issue. Rule 14 of the Board's Rules of Practice requires admission or denial only of material allegations of fact.

At the time the pleadings in this case were filed, Rules 5 and 9 of the Board's Rules of Practice required that propositions of law relied upon should be set forth in the petition and answer. The taxpayer's proposition of law was that under section 202(a) (2) of the Revenue Act of 1918 the basis for determining the gain or loss from the sale in question was the cost of the old shares. The Commissioner's proposition of law was that the Commissioner's computation had been correctly made under section 202 of the Revenue Act of 1918. In this proposition of law the Commissioner relied, as he had a right to rely, on his determination previously made, considering that determination before the Board.

The taxpayer's petition raised no issue of fact as to the stock rights, and consequently no assertion or denial with respect to them was called for. The taxpayer did, however, raise an issue of law which inevitably involved them, both in his assignment of error and in his proposition of law. No assertion or denial with respect to the facts either in the taxpayer's petition or in the Commissioner's answer was called for in view of the fact that, as has already been stated, the Commissioner's determination is the starting point in every case and is inevi-

tably involved. It is a basic assumption in every case, or, to use a legal term, the Commissioner's determination is a basic presumption in every case. Every appeal starts with a *prima facie* case in favor of the Commissioner's determination, as the decisions hereinafter cited will show. In every case the taxpayer must not only prove what he has pleaded, but he must plead facts which will, if proved, show error on the part of the Commissioner.

The Commissioner's position, therefore, is that in the instant case the pleadings formed two issues of fact and one of law. The two issues of fact were: (1) The original cost of the shares sold, and (2) the selling price. The third issue was the issue of law, whether the method of computation adopted by the Commissioner was correct as a matter of law. Moreover, every fact was pleaded on both sides which was necessary to raise these three issues, it being always assumed, as it must be assumed under the Board's rules and decisions, that the Commissioner's determination is the starting point in the case. The burden was on the taxpayer both to plead and prove facts which would show error in the Commissioner's determination and in every point in which he failed to do so, the Commissioner's determination must prevail. The taxpayer's assignments of error in a petition are always in form that the Commissioner erred in his determination in certain respects. It did not devolve upon the Commissioner to take any issue in his answer as to facts not alleged in the taxpayer's

petition in so far as the facts upon which the Commissioner relied had already been determined by the Commissioner and were set forth in the deficiency notice and in the letters or reports incorporated in the deficiency notice as a part of the Commissioner's determination.

The principles involved in the foregoing statements are fully sustained by the Board's rules and decisions.

Section 1000 of the Revenue Act of 1926, amending Title 9 of the Revenue Act of 1924, Section 907(a) (44 Stat. L. 107) provides that—

The proceedings of the Board and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence as the Board may prescribe and in accordance with the rules of evidence applicable in courts of equity of the District of Columbia.

Pursuant to this statutory provision, the Board adopted the following rule:

The burden of proof shall be upon the petitioner, except that in respect of any new matter of fact pleaded in the answer, it shall be upon the respondent. (Rule 30, amending former Rule 20.)

This rule has been applied by the Board in numerous cases to almost every fact upon which a taxpayer has sought to rely. In *Appeal of Lyon*, 1 B. T. A. 378, the Board said at page 379:

Rule 20 of this Board provides that the burden of proof is on the taxpayer. That

means that he must introduce sufficient evidence to make a *prima facie* showing that the Commissioner committed the errors alleged in the petition and to overcome the proofs submitted on behalf of the Commissioner. Such a showing must cover all the elements necessary to establish the averments of the petition. This Board is required by law to make findings of fact. Such findings can not be made upon conjecture, *ex parte* statements, or argument. They must be supported by evidence presented to the Board.

To the same effect are *Appeal of Douglas*, 1 B. T. A. 372; *Appeal of Francis Perot's Sons Malting Co.*, 1 B. T. A. 562; *Appeal of Roffwarg*, 2 B. T. A. 332; *Appeal of Eimer & Amend*, 2 B. T. A. 603; *Appeal of Findlay Dairy Co.*, 2 B. T. A. 917; *Appeal of Standard Marine Insurance Co., Ltd.*, 4 B. T. A. 853, 866; and many others.

In *Appeal of Findlay Dairy Co.*, 2 B. T. A., 917, 918, the Board said:

The taxpayer must allege and prove such facts as will support evidence of error.

The taxpayer also failed to allege in its petition or to submit as a matter of proof what action had been taken by the Commissioner with reference to the determination of the deficiency here in question. The Board is wholly uninformed, except by surmise, as to what the Commissioner did in connection with the audit of the taxpayer's returns. The taxpayer alleged four errors committed

by the Commissioner, but wholly failed to state any facts showing that the Commissioner had done anything with respect to its return other than to determine the deficiency here in question, or to state facts upon which, if proven, the Board could find that the Commissioner had erred. Under these circumstances the determination of the Commissioner must be approved.

In *Appeal of Gottlieb Bros.*, 1 B. T. A. 684, 687, the Board said:

The taxpayer claims that its liability for tax should be computed under the provisions of section 210 of the Revenue Act of 1917, for the reason that it is impossible to ascertain invested capital with accuracy. But it introduced no evidence in support of this contention. It says that even income was not clearly ascertainable from the books, so of course invested capital can not be. But the Commissioner has accepted the taxpayer's own reconstruction of its accounts, with the exception of the deduction disallowed. None of his computations has been brought into question before us, and we must presume, in the absence of evidence to the contrary, that his calculations and the figures upon which he bases them are correct, for purposes of determining both income and invested capital, with the exception of the compensation item ruled upon above.

In *Appeal of Sentinel Publishing Co.*, 2 B. T. A. 1211, 1216, the Board said:

Inasmuch as the Commissioner has determined that the property in question, consisting largely of intangibles, was acquired by the new corporation in exchange for its stock, and since the taxpayer has failed to show that it was not so acquired, the application by the Commissioner of the limitation imposed by section 326(a) (4) of the Revenue Act of 1918 in computing the taxpayer's invested capital is approved.

In *Appeal of Pleasant Valley Ranch Co.*, 2 B. T. A. 335, the Board said:

This is one of the many cases coming before this Board where it is necessary to approve the determination of the Commissioner, not because it appears that such determination is correct, but because of the failure of the taxpayer or his counsel to support his contentions by proof. In filing its income-tax return the taxpayer claimed a closing inventory of \$40,065 less than its opening inventory for the year 1918. The Commissioner disallowed such decrease and valued the inventory at the close of the year at the same figure as at the beginning of the year. The taxpayer in his petition alleged that in doing so the Commissioner committed error. Upon the hearing counsel for the taxpayer rested his case after proving a decrease of 420 head of cattle during the year. The Commissioner introduced no evidence and rested. It was explained to counsel for the taxpayer that this Board had before it none of the records of the Bureau of Internal

Revenue and only such evidence as had been adduced before it, and counsel for the taxpayer was thereupon given permission to reopen his case for the purpose of proving the inventory values. Counsel availed himself of this opportunity only to the extent of proving a part of the inventory. The law imposes upon this Board the duty of making written findings of fact and it is impossible to find facts in the absence of evidence.

The burden of proof is upon the taxpayer, and in the absence of proof that the determination of the Commissioner was incorrect, his determination must be approved.

In the *Appeal of Bank of Sweetwater*, 2 B. T. A. 621, the Board said:

We are unable to determine from the petition or from the evidence submitted by the taxpayer what action, if any, of the Commissioner forms the basis either of the determination of the deficiency here apparently in question or of the taxpayer's appeal. We have found every fact the taxpayer claims to be true. But none of these facts, standing alone, proves that the deficiencies found by the Commissioner are erroneous. We gather from the allegations of the petition and the facts as proven that a recomputation of the depreciation upon the value fixed by the Board in the above findings would result in the reduction or the elimination of the deficiency. We are not advised what the Commissioner did. We have no means of knowing whether the Commissioner added the improvements to capital

account, or what rate of depreciation the Commissioner allowed in the audit of the returns of the taxpayer. At the taking of depositions the representative of the Commissioner attempted to introduce the correspondence between the Commissioner and the taxpayer relating to this appeal to show precisely what had taken place preliminary to the determination of the deficiency. It is quite possible that if that correspondence were before the Board we would be in a position to make a finding for the taxpayer in this appeal. But the taxpayer objected to the introduction of this evidence. The witness then on the stand said: "I prefer not to answer that question inasmuch as it has been objected to."

The Board can not intelligently review the action of the Commissioner if it is not informed what action is sought to be reviewed.

In *Davis & Shaw Furniture Co. v. Commissioner*, 6 B. T. A. 705, 707, the Board said:

In the absence of specific facts relative to income, the method of computation employed by the petitioner and the method of computation used by the respondent, this Board is unable to determine whether or not the respondent's computation is erroneous.

The burden is upon the petitioner to prove by competent evidence that the respondent erred in his determination of the deficiency. This it has failed to do.

In *Appeal of Mandel Bros.*, 4 B. T. A. 341, 355, the Board said:

The Commissioner has determined that a 2 per cent rate for all of the years 1909 to 1920 is reasonable. The taxpayer has not rebutted the *prima facie* case by the mere production of its books. These show only that the return correctly reported the book entries. A line of reasoning which concluded that the presumption of the correctness of the Commissioner's determination is rebutted by the production of the very evidence which the Commissioner examined and found to reflect an unreasonable allowance and so found not from the books themselves, but from the surrounding circumstances, would be most peculiar. The Commissioner's allowance does not contradict the fact of what the books showed. It is the determination of a "reasonable allowance," and the burden is upon the taxpayer to rebut the presumption of the correctness of that determination.

In *Appeal of Hart*, 4, B. T. A. 254, 255 the Board said:

Even though the answer could be construed as admitting that payments were made in 1921 for the purposes claimed, there would still be no proof before us from which we could determine the amount of any loss which might have been sustained in 1921. It does not appear from any admission that the reduction in net loss made by the Commissioner was due to his refusal to allow the

alleged payments as deductions. There is attached to the petition what is alleged to be the statement of the Commissioner computing the deficiency, which indicates that the adjustment is due to the disallowance of these items as deductions in computing the 1921 net loss. This allegation is not admitted but is denied.

In a case where the taxpayer claims that he is entitled to certain deductions, one of the vital elements of his pleading and of his proof is to show that the deductions have not already been allowed. In the instance before us the pleading may be sufficient, but the denial of the Commissioner would make necessary proof of the fact, which is lacking. The determination of the Commissioner must be approved for want of proof.

In *Appeal of Capitol Securities Co.*, 3 B. T. A. 75, 76, the Board said:

We believe it advisable to point out that we are wholly uninformed as to the value attributed by the Commissioner to the taxpayer's property and as to the rates of depreciation used in determining the tax liability. The statement attached to the deficiency letter discloses that the deficiency was based on a revenue agent's report. No effort was made to advise us of the values and rates set forth therein, which were the basis of the Commissioner's determination. It is evident, we believe, that we can not find that the Commissioner erred unless we are first informed as to what he did in commit-

ting the error of which the taxpayer complains.

In *Appeal of Kennedy Construction Co.*, 4 B. T. A. 276, 279, the Board said:

The Commissioner's determination of values was apparently made upon the assumption that sections 326 and 331 were controlling, and is erroneous to the extent that the values thus determined are below the true values. The taxpayer had not provided us with a fact basis for a new determination of values, and we are therefore constrained to affirm the Commissioner.

In *Connorized Music Co. v. Commissioner*, 7 B. T. A. 213, 215, the Board said.

The petitioner, however, did not submit any evidence to show what the Commissioner's action was with respect to the items covered by such invoices; whether he allowed any or all of the items and, if so, whether the allowance was made in computing income for 1920 or for 1921. Neither did it submit its books nor any memoranda drawn from its books and records at the time it prepared its returns which might have reflected the composition of its accounts, or its financial status. Consequently, we can not allow any of the items covered by the invoices in this redetermination.

In *Appeal of Manville Jenckes Co.*, 4 B. T. A. 765, 803, the Board said:

Though this seventh assignment of error is applicable under the pleadings to both the

years 1918 and 1919, the stipulation set out above is limited by its terms to the year 1918. The record is entirely silent as to what the Commissioner's action in this respect may have been for the year 1919. The taxpayer is entitled under the statute to a deduction representing a reasonable allowance for depreciation of all of its physical assets which are not the proper subject of an amortization allowance; and the Commissioner's computation of net income, for both years, is in error, to the extent that he has failed to include such a deduction.

These numerous Board decisions have been referred to and quoted from because the Board's own rule which is involved and the Board's construction of that rule are entitled to more than ordinary weight on account of the Board's statutory authority to determine its own rules of practice and procedure. That the Board's rule is a reasonable one appears clearly from the fact that it is in accord with the well-recognized rule as to the presumption of correctness of official decisions and findings.

These cases show that the burden is on the taxpayer not only to prove what he has pleaded, but to plead facts sufficient to show that the Commissioner erred, and if his pleadings or his proof are insufficient, he is not entitled to a decision. They also show that the Board assumes the Commissioner's determination as the starting-point of every case, and it is only to the extent that such determination is controverted by allegations and proof that the

taxpayer is entitled to a decision. They also show that the prima facie case established by the Commissioner's determination extends to the specific facts and figures determined by the Commissioner.

The instant case is much like the *Appeal of the Bank of Sweetwater*, 2 B. T. A. 621, in which the Board stated in its opinion that it had found every fact the taxpayer claimed to be true but that these facts were insufficient to prove that the deficiencies were erroneous. So in the instant case, the Board's finding that the original cost of the old shares and their selling price were as claimed by the taxpayer, were insufficient to show that the Commissioner had erred because there was an additional fact which the Commissioner had determined which was sufficient to sustain the deficiency.

The case is also similar to the *Appeal of Mandel Bros.*, 4 B. T. A. 341, 355, where the Board said that a line of reasoning which concluded that the presumption of the correctness of the Commissioner's determination is rebutted by the production of the very evidence which the Commissioner examined and found to reflect an unreasonable allowance and so found not from the books themselves, but from the surrounding circumstances, would be most peculiar. The Board also there said that the Commissioner's allowance did not contradict the fact of what the books showed, and that the burden was upon the taxpayer to rebut the presumption of the correctness of the Commissioner's determination of a "reasonable allowance" for depreciation. So in

the instant case, a line of reasoning which concluded that the presumption of the correctness of the Commissioner's determination was rebutted which did not take any account whatever of one of the essential elements of that determination would be most peculiar.

The taxpayer argues that whether or not the exercise of stock rights was involved, and the effect of such exercise if it was involved, were affirmative defenses which should have been pleaded by the Commissioner. It has been pointed out, however, that the Commissioner need not set up affirmatively facts which are a part of his determination. So far as the effect of the exercise of stock rights was concerned that was an issue of law which was raised by the taxpayer in his petition. In arguing that it devolved upon the Commissioner to set up the facts affirmatively, the taxpayer wholly leaves out of account the effect of the Commissioner's determination. The Board's decision showed that it is unnecessary for the Commissioner to allege affirmatively that which he has determined in arriving at a deficiency.

The taxpayer argues that such a rule as this, applied as the Board has applied it in this case, would mean that the taxpayer must negative every fact which could possibly affect the computation of the profit from such a sale as this. In particular the taxpayer refers to the effect of distributions in liquidation and their effect on the basis for determining profit from a sale of the stock, and asserts

that since any dividend may distribute some of the surplus of the corporation, it would be necessary for the taxpayer to make a careful investigation into every dividend declared and to prove all of the facts which would show that it had not involved a distribution of surplus. The taxpayer also argues that the rule so contended for is equivalent to a rule which would compel the taxpayer in a negligence case to prove that he had never in his life been guilty of contributory negligence.

The taxpayer in these arguments has left wholly out of account the fact that it is the Commissioner's determination which places upon him the burden of proving what might be held otherwise an affirmative defense. The taxpayer does not have to disprove that which the Commissioner has not determined. If it did not appear in the instant case that the Commissioner had determined that stock rights had been issued to the taxpayer with respect to the old shares sold, and that they had been exercised, and their cost, it would not devolve upon the taxpayer to controvert these facts. The Commissioner made no determination with respect to ordinary dividends that they included any element of surplus, and consequently no burden rested upon the taxpayer to prove that the dividends did not contain such surplus. The Board in its opinion states that the original cost of stock is not necessarily the basis for determining profit and loss, but that this cost may be increased by the payment of assessments or decreased by liquidating dividends, stock

dividends, or the exercise of rights to subscribe to stock. The Board, however, makes no statement in its opinion that it devolves upon the taxpayer to offer proof with respect to any of these things about which the Commissioner has made no determination. The Board's decision rested on the ground that the Commissioner had determined that there was such an exercise of stock rights in the instant case, and properly held that it devolved upon the taxpayer to disprove that such stock rights had been exercised.

The taxpayer says (Brief 23) :

Enough has been shown, however, to demonstrate how impracticable and impossible on the one hand, and unfair and unnecessary on the other hand, it would be to impose upon the petitioning taxpayer the burden of disproving a myriad of fanciful facts that have nothing to do with the case.

It is believed that enough has been said in this brief to demonstrate that the Board's decision involves no such consequences, and that the Commissioner does not assert any such rule. In this case clearly the taxpayer has set up a number of straw men to knock over, and there is no basis whatever for so much of the taxpayer's argument in any principle involved in the Board's decision or any consequences following from it.

The general rules of pleading and evidence referred to by the taxpayer are applicable only if in applying them account is taken of the fact that in

the cases before the Board the Commissioner's determination makes a prima facie case until that determination is controverted by pleading and proof. The taxpayer refers to a number of Board cases in support of his position. Among them is the *Appeal of Buffalo Wills-Sainte Claire Corporation*, 2 B. T. A. 364 (Brief 12). That case, however, sustains the Commissioner's position for the holding is that unless the taxpayer pleads facts in its petition essential to show error in the Commissioner's determination, the Commissioner's determination will be approved. If the taxpayer's contention were correct, the Board should have held that the matters which the taxpayer failed to allege were matters which the Commissioner should have set up by affirmative allegations in his answer and that since this was not done, no issue was raised with respect to them, and the decision should have been for the taxpayer. Contrary to such a view, the Board's decision is based on facts not suggested either in the petition or in the answer. The decision holds that in the event of the failure of the taxpayer to plead, he is not entitled to a decision, even where the Commissioner raises no issue by affirmative allegations and also states that the question is one of law on the facts stated in the pleadings. It was in the taxpayer's petition, not in the Commissioner's answer, that the Board could not supply deficiencies.

The taxpayer cites *Appeal of Weaver*, 2 B. T. A. 709 (Brief 12) and *Crosswell v. Commissioner*, 6

B. T. A. 1315. Both of these cases differ from the instant case in the very essential respect that the burden rests upon the taxpayer to allege and prove error, while no such burden rests upon the Commissioner, and in both cases it was the failure of the taxpayer to raise the issue and sustain the burden of proof which caused him to fail.

The argument so far has assumed that the exercise of stock rights and the effect of such exercise in determining gain or loss was in issue in the case. In the Commissioner's view, however, the taxpayer is no better off if it be assumed that the issue was not before the Board.

For the purpose of the argument which follows let it be assumed that the issue in question was not before the Board, that the only issues were as the taxpayer repeatedly states in his brief, the original cost of the old shares and their selling price. The evidence shows that the Commissioner determined that there were stock rights, that they were exercised, and their cost. The taxpayer does not assert in his petition that no such stock rights were involved. He makes no allegation of fact with respect to stock rights. It follows that the Board's decision must be confined to the decision of the issues before it. Assuming that the decision as to these issues should be in favor of the taxpayer, the Board's finding and decision must be that the original cost of the old shares was as proved by the taxpayer, that their selling price was as proved by the taxpayer, and that the deficiency must be deter-

mined by using such values for original cost and selling price, leaving the Commissioner's determination otherwise exactly as it was made. This is all that the taxpayer is entitled to if his position as to the issues and the proof is correct. On these issues and that proof, the Board can make no finding whatever with respect to stock rights, and if they were determined by the Commissioner, they remain in the case exactly as determined by him.

This point will be somewhat clearer if one of the differences between the usual procedure in cases before the Board and the most common procedure in tax cases before a Court is pointed out. The Board, by Rule 50 of its Rules of Practice, provides as follows:

When the Board makes a decision directing the redetermination of the amount of the deficiency or a redetermination indicating an overpayment of tax, the procedure shall be as follows: (1) The parties may stipulate that the deficiencies or overpayments as the case may be shall be redetermined at a stated amount, and file the stipulation as the basis of an order on consent. (2) Either party may prepare a proposed redetermination showing the basis and method of its computation and file an original and four copies thereof with the Board accompanied by a notice that it will be presented to the Board for order on a stated day (other than a Friday or Saturday) not sooner after filing than the number of days allowed in the Board's decision. The Board will serve one copy on

the adverse party and the latter shall show cause by filing before the day stated in the notice an original and four copies of an alternative proposed redetermination. Failure so to propose an alternative redetermination will be treated as a consent to the redetermination theretofore proposed by the adverse party and order will be entered accordingly. Proposals of redetermination noticed for settlement and contested will be called in the regular daily calendar call of the Board, and will be assigned to the Division from which the decision emanated for disposition on the papers filed or after hearing as the situation may require.

It is not the common practice to prove at a Board hearing the effect which any particular fact will have on the deficiency determined by the Commissioner. The Board hears the evidence and makes findings of fact and renders its decision to the effect that the deficiency shall be recomputed in accordance with such findings and with its opinion. One of the most common forms of decision is as follows:

The deficiencies should be computed in accordance with the following opinion. Final determination of the Board will be settled on 7 day's notice, under Rule 50. (*Appeal of General Lead Batteries Company*, 2 B. T. A. 392, 394.)

In submitting a case to the Court, however, it is common practice for the parties to agree before the Court that if certain facts in issue are found by the Court, the tax will then be a certain amount,

while if these facts are not found, or if certain other facts are found, then the tax will be a certain other amount. If such an agreement is not made, then the Court usually follows a practice similar to that of the Board, and leaves it to the parties to agree as to the amount of the tax. It is obvious that in the instant case, the Commissioner would never have agreed that if the original cost and the selling price of the old shares were proved by the taxpayer as alleged in his petition, then the tax should be the amount claimed by the taxpayer. The most important issue, the issue of law as to the method of taking into account the stock acquired by the exercise of stock rights was still left in the case. In the *Appeal of General Lead Batteries Co.*, supra, cited by the taxpayer (Brief 17), an affirmative defense had been set up and there was therefore no prima facie case in favor of the Commissioner as to such issue. The case shows that the effect of the Commissioner's determination is not merely that the deficiency is correct, but goes to the basis of facts on which that determination is founded, that what the Board presumes is not merely something about the deficiency in general, but the Commissioner's action with respect to specific issues. The Board, therefore, gives the taxpayer the benefit of a finding on the issue raised affirmatively by the Commissioner and refuses to deny such benefit merely because some other ground not resting on a prima facie basis might offset the effect of the decision. The Commissioner had ad-

mitted in his answer that his determination of income improperly included \$3,697.97. The Board said not that there was no deficiency, but simply that the income should be reduced by the amount improperly included. The form of decision is a typical one.

The same point is also clearly brought out in the *Appeal of Manville Jenckes Company, supra*, 4 B. T. A. 765, 803. In that case, not having been informed as to the Commissioner's action with respect to the year 1919, the Board merely decided that the taxpayer is entitled to a reasonable allowance for depreciation of certain physical assets and that the Commissioner's computation is in error to the extent that he failed to make such reasonable allowance.

In *Hughes Coal Company v. Commissioner*, 8 B. T. A. 306, the Board's decision was that the deficiency should be recomputed by allowing certain rates of depreciation on certain assets, and directed a Rule 50 determination. Nothing was said about the amounts to which the rates were to be applied nor to the effect of the decision on the income or the tax liability, the obvious intention being that the computation should be made otherwise just as the Commissioner had made it.

In *Piedmont-Mt. Airy Guano Company v. Commissioner*, 8 B. T. A. 72, the Board's decision was that a certain March 1, 1913, value found by it should be used in determining the profit, if any, on the sale of the taxpayer's plant, and directed a

Rule 50 determination. No decision was made even that there was any profit at all.

In *Becker v. Commissioner*, 8 B. T. A. 65, the Board's decision was that certain accounts receivable should be taken at 45 per cent of their face value in determining the taxpayer's profit from a corporate liquidation, and directed a Rule 50 determination.

In *Huyler's v. Commissioner*, 8 B. T. A. 13, 40, the Board's decision was that certain March 1, 1913, property values found by the Board should be used in computing the gain derived from the sale of the properties.

These decisions are merely typical instances out of a large number where the Board has found a certain fact and directed a recomputation of the tax by the use of such fact, without disturbing otherwise the Commissioner's determination.

Moreover, in most of its cases, including a number of those herein cited, the Board, either in its findings of fact or in its opinion, makes a statement as to what the Commissioner did, then picks out the particular fact entering into his computation which the taxpayer controverts, and makes a decision as to such fact. If the Board has before it other facts sufficient to show just what effect the fact found will have on the income or the tax, its decision will then generally show also such effect. Otherwise, the decision will be confined to a finding of the fact in controversy, and a direction that

the tax be recomputed by the use of the fact as found, as was done in the typical cases cited.

The Board will not in any case go beyond the facts which are before it, and in the instant case, as has already been stated, if the taxpayer's position with respect to the issues and the proof is accepted, it is entitled to a decision merely to the effect that the original cost of the old stock was as proved, that the sale price was as proved, and that the tax should be recomputed by taking account of such values. Obviously this could not and should not affect what the Commissioner had done with respect to stock rights, for by the taxpayer's own contention he made no allegation and submitted no proof with respect to them, and it is not a matter for affirmative allegation by the Commissioner because it was a part of his determination.

It would have been perfectly proper in this case for the Board, instead of stating in general language what the Commissioner did, to have set forth either in its findings of fact or in its opinion, a copy of that portion of the Revenue Agent's Report (Joint Exhibit A) showing the computation of the profit from the sale of the stock in question. For that matter, it would have been proper enough to set forth the entire report, except that it would have been wholly unnecessary since only the sale was involved. The report was in evidence to show what the Commissioner did and all or any portion of it could properly be utilized for that purpose. If

this had been done it is perfectly clear that the Board should have gone no further than to decide that certain amounts proved by the taxpayer as the original cost and the sale price of the old shares should be inserted in that computation of the profit, which otherwise would remain exactly the same except in so far as held to be erroneous as a matter of law. This follows inevitably from the rule that the Commissioner's determination stands unless and in so far as it is not shown to be erroneous. It follows whether the question of stock rights was before the Board or not. If the question was in issue the Board must approve the Commissioner's determination as to the facts, leaving to the Board only the question of law whether it was proper to give them effect in the computation as the Commissioner did. If the question was not in issue, the Board must still approve the Commissioner's determination as to the facts, but has no question of law to consider because no such issue was before the Board.

It is therefore believed that whichever horn of the dilemma the taxpayer chooses, he is not entitled to a decision that the Commissioner made any error in taking into account the cost of the stock acquired by the exercise of stock rights. If any question with respect to stock rights was in issue then the taxpayer must fail for want of proof, and the Board properly approved the Commissioner's determination because it was evident from the facts before it that the computation of the profit would

not be changed by the amounts proved. If this question was not in issue, as contended by the taxpayer, then the Board could make no decision with respect to stock rights, but could decide only that the original cost and the selling price of the old shares were as contended for by the taxpayer. Whether or not decision should have been entered for the Commissioner depends upon whether or not these amounts were the ones used by the Commissioner in his computation, and since these were the amounts used by the Commissioner, it is equally obvious in this alternative that the Commissioner's determination should have been approved.

When the Board in its opinion says there was no dispute between the Commissioner and the taxpayer as to the original cost of the stock in question or its selling price, the reference is clearly to the actual conduct of the case and not to the theoretical issues. As a matter of fact, the taxpayer proved the same amounts which the Commissioner had used in his determination, and no attempt was made in behalf of the Commissioner to controvert those figures. It was therefore perfectly proper to say that there was no dispute about them.

Moreover, when the Board says that the sole issue was whether the original cost was decreased by the exercise of stock rights, it was a clear recognition of the issue as one of law, and that issue of law, as has already been shown, was clearly raised by the pleadings. The taxpayer is arguing before

this court that even if there was an exercise of stock rights by him, the cost of the old stock was not decreased or affected by such exercise. The Board's decision was therefore based on a clear recognition of the issues and of the proof.

CONCLUSION

The Commissioner submits that the only decision other than an approval of the Commissioner's determination which in any view would be warranted by the record in this case would be that a recomputation should be made on the basis of findings that the original cost and the sales price of the old shares were as proved by the taxpayer; but in view of the fact that the record shows these amounts were used by the Commissioner in his determination, no such decision, although perfectly proper in form, is called for.

The Commissioner therefore submits that this court should affirm the decision of the Board approving the Commissioner's determination.

MABEL WALKER WILLEBRANDT,
Assistant Attorney General.

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

JOHN W. FISHER,
Special Attorney,
Bureau of Internal Revenue.

FEB 3 - 1928

Henry H. Hodgson
Blair

IN THE
Court of Appeals, District of Columbia

APRIL TERM, 1927.

—
No. 4627.
—

. FREDERICK AYER, *Appellant*,

vs.

DAVID H. BLAIR, COMMISSIONER OF INTERNAL REVENUE,
Appellee.

—
REPLY BRIEF FOR APPELLANT.
—

JAMES CRAIG PEACOCK,
JOHN W. TOWNSEND,
Attorneys for Petitioner.

WHEATON KITTREDGE,
Of Counsel.

IN THE
Court of Appeals, District of Columbia

APRIL TERM, 1927.

No. 4627.

FREDERICK AYER, *Appellant*,

vs.

DAVID H. BLAIR, COMMISSIONER OF INTERNAL REVENUE,
Appellee.

REPLY BRIEF FOR APPELLANT.

Since the filing of our main brief there have been handed down by this Court and by the Supreme Court of the United States several decisions which are so pertinent that we feel they should be brought to the attention of the Court in connection with the case at bar. We refer particularly to *Martin v. Coit*, 55 Wash. L. R. 846, 22 Fed. (2d) 878, decided by this Court on November 7, 1927; *Lewis-Hall Iron Works v. Blair*, decided by this Court on January 3, 1928; and *Blair v. Oesterlein Machine Co.*, 274 U. S. 730, decided by the Supreme Court on November 21, 1927.

I.

It will be recalled that our first point at pages 6 to 13 (to the effect that the question whether there had even been an exercise of stock rights was not in issue) turned largely on the Board's Rule 9 which provided that the Commissioner's answer:

“shall be so drawn as fully and completely to advise the taxpayer and the Board of the nature of the defense. It shall admit or deny each material allegation of fact contained in the petition and set forth any new matters of fact and propositions of law upon which the Commissioner relies.”

It is, of course, established law that rules of court have the force and effect of law, but the status of the Board's rules had apparently not been passed on by an appellate court (except with regard to its rules as to admission of attorneys, *Goldsmith v. Board*, 55 App. D. C. 229) until January 3, 1928. On that date this Court in *Lewis-Hall Iron Works v. Blair*, as yet unreported, in sustaining the Board's rule that its office is open only until 4.30 p.m., held unequivocally that:

“The Board of Tax Appeals is authorized to prescribe reasonable rules of procedure for conducting its business. Section 900, Revenue Act of 1924. This court will take judicial notice of the Board's rules when regularly promulgated.”

We ask therefore that this Court take judicial notice of those provisions of Rule 9 which require the Commissioner to draw his answer so as “fully and completely to advise the taxpayer and the Board of the nature of the defense” and “to set forth any new matters of fact * * * upon which the Commissioner

relies.” Examination of his answer as printed in full at R. 9-10 shows that it afforded to the Board not the slightest suggestion or intimation that any alleged exercise of stock rights might be involved in the case.

In this connection see also *Nealon v. Davis*, 55 Wash. L. R. 278, 18 Fed. (2d) 175, in which this Court in sustaining a rule of court providing for clerk’s entry of dismissal without prejudice for want of prosecution said:

“The rule of court in question had the force and effect of law in the case within the sense of the foregoing authority, and it has been said in respect to such rules that ‘there is no dispensing power in the court, simply to meet what is supposed to be the pressing exigency of a particular case.’ *District of Columbia v. Humphries*, 11 App. D. C. 68; *District of Columbia v. Roth*, 18 App. D. C. 547; *Talty v. D. C.*, 20 App. D. C. 489; *Murphy v. Gould*, 39 App. D. C. 363.”

The earlier cases cited in the above extract all confirm the principle which has been so well expressed in *Magnuson v. Billings*, 152 Ind. 177, 52 N. E. 177, in these words:

“A rule of court is a law of practice, extending alike to all litigants that come within its purview, and who, in conducting their cases, have the right to assume that it will be uniformly enforced by the court, in conservation of their rights, as well as to secure the prompt and orderly despatch of business * * *.”

Thus in *Talty v. District of Columbia*, 20 App. D. C. 489, this Court said at page 491:

“The rule was made by the express authority of the act of Congress in order to give the same complete and definite effect. It has the force of law, and is binding upon the court as well as parties, and can not be dispensed with by the court to meet the hardship of a particular case. *District of Columbia v. Roth*, 18 App. D. C. 547, 550; *Rio Grande Irrigation Co. v. Gildersleeve*, 174 U. S. 603, 608.”

and in *District of Columbia v. Roth*, 18 App. D. C. 547, it said at page 550:

“These rules would be of varying force, and of little value either to the court or suitors, and consequently very imperfect regulations of the subject, if their limitations and provisions could be dispensed with upon any and all occasions when circumstances might show a possible hardship to the party who had failed to observe the requirements of the rules, whether such failure be occasioned by mistake, oversight or otherwise. But these rules, so long as they remain unrescinded, cannot be dispensed with by the court to meet the apparent hardship of any particular case, in the absence of fraud. They have the force of law, and are binding upon the court, and upon the suitors and those who represent suitors. This is the principle that prevails generally in the courts of the country. The case of *Thompson v. Hatch*, 3 Pick. 512, is a leading case upon this subject * * *.”

In *Thompson v. Hatch*, 3 Pick. (Mass.) 512, the leading case just referred to, it was held:

“But a rule of the court thus authorized and made, has the force of law and is binding upon the court, as well as upon the parties to an action, and cannot be dispensed with to suit the circumstances of any particular case.”

II.

In our main brief we also submitted, particularly at pages 13 to 24, that under the law and the Board's rules the alleged exercise of stock rights, if relevant at all, was an affirmative defense to be pleaded and proved by the Commissioner. On November 7, 1927, this Court in *Martin v. Coit*, 55 Wash. L. R. 846, 22 Fed. (2d) 878, passed on a case which is almost parallel in every respect.

That case arose under the rules of the Supreme Court of the District of Columbia which provide that the plea of the general issue is abolished and every pleading shall set forth the true facts upon which the pleader relies (a provision in effect identically the same as the Board's rule that the answer must fully and completely advise the Board of the nature of the defense and set forth any new matters of fact upon which the Commissioner relies). The suit was for alienation of affections of plaintiff's husband and, under a reply denying that plaintiff was lawfully married to her husband on the day on which the performance of the ceremony was alleged, the defendant offered testimony to the effect that on that date the husband's divorce secured in another state had not yet become finally effective. The trial court admitted the testimony over objection, just as in the present case the Board in effect held that the Commissioner was not obliged to plead affirmatively the defense of alleged exercise of stock rights. This Court reversed the judgment below, saying:

“When defendant offered testimony relative to the California divorce proceedings, objection was made by counsel for plaintiff on the ground that

the testimony was inadmissible under the pleadings in the case. The objection was overruled, and exception reserved. On this point we think the case turns. Law rule No. 23 of the Rules of Court of the Supreme Court of the District of Columbia provides:

‘1. The plea of the general issue is abolished.

‘2. Every pleading shall set forth the true facts upon which the pleader relies.’

It is urged by counsel for plaintiff that the mere denial of the allegation of the marriage ceremony, performed at Washington on February 19, 1925, is insufficient under the rules to admit of proof of the California divorce proceedings. Without stopping to consider the sufficiency of the answer, for any purpose whatever, since it attempts to traverse a question of law, it is clear, we think, that under the pleadings it was error for the court to admit proof of the California divorce proceedings. This constituted an affirmative defense to the case as alleged and proved by the plaintiff. Certified copies of the record of the clerk’s office of the Supreme Court of the District showing a legal and lawful marriage between plaintiff and Merton G. Martin were introduced as part of the plaintiff’s case and admitted without objection. To defeat this proof, defendant resorted to the affirmative defense of proving the California divorce proceedings. Such a defense, under the rule, can only be availed of by pleading the facts upon which it is based.

A general denial under the practice in this District challenges only the material facts alleged in plaintiff’s petition, and is not sufficient to admit of proof by way of affirmative defense. The manner of pleading affirmative defenses under statutes or rules of court similar to ours is clearly stated in *Piercy v. Sabin*, 10 Cal. 22, 27, 70, Am. Dec. 692, where the court said:

‘The plaintiff is required to state in his com-

plaint the facts that constitute his cause of action; and it seems to have been the intention of the Code to adopt the true and just rule that the defendant must either deny the facts as alleged, or confess and avoid them. It is certain that, where new matter exists, it must be stated in the answer. The answer "shall contain a statement of any new matter constituting a defense." The language of this section is very clear, that this new matter, whatever it may be, must be set up in the answer. The question then arises: What is "new matter" in the contemplation of the Code itself? New matter is that which, under the rules of evidence, the defendant must affirmatively establish.' "

The Board's rules of pleading as already explained are substantially the same, and its rules of evidence (as expressly provided in Section 907(a) of the Revenue Act of 1924, as amended by Section 1000 of the Revenue Act of 1926) are identically the same, as in the courts of the District of Columbia, and it is submitted that *Martin v. Coit* is controlling in support of our position that the Commissioner's defense was an affirmative one which he had to plead and prove.

That the alleged exercise of rights was "new matter" and an affirmative defense had been admitted outright by the Commissioner's own actions—and actions speak louder than words. Otherwise why did he at the trial before the Board call three witnesses in a vain effort to prove the alleged exercise of rights (R. 27-29)? And if in turn we are asked why we did not object to such questioning as did counsel in *Martin v. Coit, supra*, the answer is that it is common practice in the Board for pleadings to be amended to conform to the proof *at any time up until but not after the con-*

clusion of the hearing, this being in accordance with the Board's Rule 18 that:

“Upon motion made, the Board may, in its discretion, at any time before the conclusion of the hearing, permit a party to a proceeding to amend the pleadings to conform to the proofs.”

III.

In his brief the Commissioner nowhere squarely meets and answers our contentions that we satisfied our burden of proof and that his alleged defense was an affirmative one to be pleaded and proved by him. His very failure to meet the issues squarely is itself a confession of inability to do so, and his obvious effort to obscure them in the long, involved point stated at pages 7 and 20 of his brief only confirms that conclusion. Analysis of the cases cited at pages 24 to 34 of his brief shows, however, that they hold little more than that the taxpayer must prove “what action had been taken by the Commissioner” and “what the Commissioner did” (*Appeal of Findlay Dairy Co.*); “what the Commissioner did” (*Appeal of Bank of Sweetwater*); “the method of computation used by the respondent” (*Davis & Shaw Furniture Co. v. Commissioner*); “that the deductions have not already been allowed” (*Appeal of Hart*); “what he did in committing the error of which the taxpayer complains” (*Appeal of Capital Securities Co.*); “what the Commissioner's action was” (*Connorized Music Co. v. Commissioner*); and “what the Commissioner's action in this respect may have been” (*Appeal of Manville-Jenckes Co.*). It is a reasonable and obviously necessary requirement that the taxpayer should show that

the Commissioner has not already allowed the particular adjustment that is being claimed, and that is exactly why we had to and did introduce the Revenue Agent's report (R. 25) solely to show that the Commissioner had disallowed a part of the deduction claimed and used a cost basis of only \$75,318.75 (R. 19).

These cases fall far short of establishing such a "supposedly sacrosanct character of his determinations" as is urged by the Commissioner—if we may use the words of Mr. Justice Stone in the unanimous opinion of the Supreme Court which he announced on November 21, 1927 (274 U. S. 730), in affirming the decision of this Court in *Blair v. Oesterlein Machine Co.* (55 Wash. L. R. 146, 17 Fed. (2d) 663). Any claim that such effect should be given the Commissioner's determination is effectually disposed of by the final utterance of the Supreme Court in that case, in which that Court refused even to give such effect to a determination under Sections 327 and 328 relating to "special assessment," let alone to an ordinary determination such as in the present case. The Court said:

"An examination of the sections creating the Board and investing it with power can leave no doubt that they were intended to confer upon it appellate powers which are judicial in character. Not only is it required by Sec. 900(e) to hear and determine appeals taken under Sec. 274, which in terms allows an appeal in every case where a deficiency is found by the Commissioner, but it is empowered to administer oaths and to compel the attendance of witnesses and the production of documents and records. It may investigate anew the issues between the government and the taxpayer and upon the determination of the appeal it may affirm, set aside or modify the findings and

decision of the Commissioner. In the light of such provisions there is plainly no sufficient ground for reading into Sec. 274, allowing an appeal wherever a deficiency is found by the Commissioner, an exception based on the supposedly sacrosanct character of his determinations under Secs. 327 and 328."

IV.

All of which leads us back to our original starting point, viz., Rule 9 (now Rule 14) of the Board of Tax Appeals, which we quoted on page 9 of our main brief, and which we have already reiterated several times in this reply brief. That rule, which has the effect of law, in itself controls this case. The Commissioner in his brief studiously avoids even the slightest reference to its requirements that he "advise the taxpayer and the Board of the nature of the defense" and "set forth any new matters of fact * * * upon which the Commissioner relies," and we submit that the sentence beginning at the bottom of page 23 of his brief is directly contrary to the requirements of that rule. What other conclusion can be reached than that he cannot answer our argument based on that rule?

V.

We turn now to another aspect of this same question. The Commissioner argues that his determination is the starting point in a most exhaustive and all-embracing sense of that term, and particularly that on appeal to the Board it carries with it a presumption of the truth of the facts on which it is based. But he overlooks the fact that in his answer he had already repudiated the principal facts on which the computation of the loss on the sale of this particular First Na-

tional Bank stock was based in that determination and had accordingly debarred himself from taking advantage of any such presumption even were it as far reaching as he contends.

The Commissioner's determination (R. 7, 8) was based on the use of a "corrected" cost of \$75,318.75 (R. 19) which figure was in turn computed by the use of two factors (R. 27-28) viz.—

Cost of 300 shares purchased in 1914 to 1917 for	\$120,637.50
Cost of 300 shares alleged to have been purchased through exercise of rights in 1920.....	30,000.00

the "corrected" cost being the average of these two figures.

But in his answer the Commissioner not only failed to plead the second factor, *but expressly and unequivocally denied the first factor* (R. 6, 10), and similarly denied the selling price of \$85,500 (R. 6, 10) which had likewise been used without question in his determination, and at the trial he reaffirmed these denials by forcing the taxpayer to the trouble, and the Board to devote the necessary time, to prove these facts in detail (R. 25-27).

It is obvious that he cannot blow hot and cold at the same time—he cannot have his cake and eat it too. He cannot in the same breath claim the benefit of his determination when it is to his advantage, and at the same time deny the facts on which it is based. Having consistently elected to stand on his denial, he must abide the consequences, which are clearly set forth—not in the long line of inapplicable Board decisions which he has quoted—but in *Appeal of Bruce v. Hu-*

man Drug Co., 1 B. T. A. 342. In that case the Commissioner determined a deficiency on the basis of a Revenue Agent's Report. At the trial the only evidence was the report, which showed what he had done and also showed obvious errors on its face, and an audit report by the taxpayer's public accountant which showed equally obvious errors and was held by the Board not to be satisfactory proof of anything. On this record the Board very properly held that:

“A deficiency determined by the Commissioner on the basis of a report of an examining revenue agent which is erroneous on its face, will be disallowed notwithstanding the rule of this Board that the taxpayer must bear the burden of proof on his appeal.”

We submit that a similar situation exists when as here the essential factors in the report are denied and repudiated by the Commissioner in his pleadings, and at the trial, and that the deficiency should therefore be disallowed and judgment entered for the taxpayer appellant.

VI.

Without attempting or purporting to exhaustively list or answer all statements in the Commissioner's brief with which we cannot agree, we do take this opportunity to enumerate a few of the more outstanding among them (the references unless otherwise noted being to pages of the Commissioner's brief):

(1) In quoting at pages 9-10 from the *Miles case*, the Commissioner has stopped too short, and in order to get the full context we ask that in this connection the three immediately succeeding sentences be read.

They may be found at pages 28-29 of our brief. The same is true in the quotation from the *Lyon case* at pages 24-25, the balance of the context being found at page 16 of our brief.

(2) The "inexorable logic" test suggested at page 11 is not an accepted principle of statutory construction. Legislative bodies are not always logical, and we know of no case holding that they are presumed to be. Furthermore it is to be remembered that, unlike the *Miles case*, this is a case where it is attempted to read in a construction *for the purpose of increasing a tax*. At pages 29-30 of our brief we cited the well established decisions of the Supreme Court on this point, and the Commissioner's failure to attempt to answer them, or even to refer to them, must once again be taken as his acknowledgment that it cannot be done. The appeal to "logic" in a case involving construction of a taxing statute is only too well answered in a sentence from a decision of the House of Lords which was approved and adopted by our own highest court in *United States v. Merriam*, 263 U. S. 179, at page 188:

"On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject **within the letter of the law**, the subject is free, **however apparently within the spirit of the law** the case might otherwise appear to be."

(3) The case of *Towne v McElligott*, discussed at pages 14-15, is obviously and fundamentally different. It is a stock dividend case in which the new shares were received *without any cost or effort on the part of the taxpayer* and merely as an incidental result of his original investment. That is quite different from the present case where the new shares were acquired

only upon a definite expenditure by Mr. Ayer of a new cost of \$100 per share.

(4) The "real answer to this point" at page 17 does not answer the question at all. It utterly fails to explain in any way how two entirely different interpretations can both be the true and correct interpretation of a substantially similar and unchanged statutory provision.

(5) The suggestion at page 47 that the Board's statement (that there was no dispute as to original cost or selling price) refers "clearly to the actual conduct of the case and not to the theoretical issues," makes pertinent the question as to why then did Commissioner at the trial by his silence force us to take up the Board's time in proving those facts by two witnesses and a large amount of documentary evidence (R. 25-27)? The conclusion cannot be avoided that the Board's decision shows a complete misconception of both the law and the record.

Conclusion.

For reasons already fully presented we again submit that the decision below should be reversed with directions to enter judgment for the Commissioner in the amount of only \$727.96, as suggested in Point V, at pages 35 to 37, of our main brief.

Respectfully submitted,

JAMES CRAIG PEACOCK,
JOHN W. TOWNSEND,
Attorneys for Petitioner.

WHEATON KITTREDGE,
Of Counsel.

